REPORT OF THE WORKING GROUP TO REVIEW THE SYSTEM OF CASH CREDIT

सत्यमेव जयते

RESERVE BANK OF INDIA
BOMBAY
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CHAPTER I

Introduction

1.1 Following his meeting with bankers, the Governor, Reserve Bank of India, advised all scheduled commercial banks on the 30th November 1978 that they should "so plan their future expansion of non-food credit that the incremental gross credit (non-food)—deposit ratio for the period December 1, 1978 to end-March 1979 would be well within 40 per cent". While reviewing the monetary and credit trends in March 1979, the Governor again stressed the need for exercising continued restraint on further expansion of credit. He also indicated in the meeting the need for considering certain long-term issues relating to banking operations. In his letter dated the 16th March 1979 to all scheduled commercial banks, he indicated:

Backdrop and terms of reference

> "I would like to initiate action on certain structural matters which need further examination. It is necessary to take a fresh look at another major problem faced by banks in implementing the credit regulatory measures, viz., the extensive use of the cash credit system. Its drawbacks have been pointed out by various Committees in the past including the Tandon Committee, which suggested the bifurcation of credit limits into a demand loan and a fluctuating cash credit component. Although the banks were advised to implement this recommendation, I am afraid, the progress achieved has been very slow. Clearly, this problem needs to be looked into further and for this purpose I propose to set up immediately a small Working Group, to report to me........ on the reforms to be introduced".

It was in this context that the Reserve Bank appointed the Working Group to review the system of cash credit in all its aspects. The terms of reference are as follows:

(*i*) To review the operation of the cash credit system in recent years, particularly with reference to the gap between sanctioned credit limits and the extent of their utilisation;

(*ii*) In the light of the review, to suggest:

- (*a*) modifications in the system with a view to making the system more amenable to rational management of funds by commercial banks, and/or
- (*b*) alternative types of credit facilities, which would ensure greater credit discipline and also enable banks to relate credit limits to increases in output or other productive activities, and

(*iii*) To make recommendations on any other related matter as the Group may consider germane to the subject. A copy of the Memorandum regarding the constitution of the Working Group is given in Appendix I.

1.2 The members of the Group are:

1.	Shri K.B. Chore,@ Additional Chief Officer, Department of Banking Operations & Development, Reserve Bank of India, Central Office, Bombay	..	Chairman
2.	Shri S.P. Chandavarkar, Senior Deputy General Manager, Union Bank of India, Bombay	..	Member
3.	Shri V. Mahadevan, General Manager (Planning), Local Head Office, State Bank of India, Bombay	..	Member
4.	Shri R.P. Vaidya,* Deputy General Manager, Bank of India, Bombay	..	Member
5.	Kum. M. Tyagarajan, Director, Economic Department, Reserve Bank of India, Bombay, and	..	Member
6.	Shri M.L. Inasu, Joint Chief Officer, Department of Banking Operations & Development, Reserve Bank of India, Central Office, Bombay	..	Member-Secretary

Methodology

1.3 The Working Group held its first meeting on the 9th April 1979 to discuss the methodology to be adopted and the information to be collected. It was decided at that meeting to analyse the available data in the Reserve Bank of India from the Basic Statistical Returns (BSR) and returns under the Credit Authorisation Scheme (CAS) in order to ascertain the gap between sanctioned credit limits and the extent of their utilisation. The Group also decided to collect some additional information from the major banks and to request them to make a sample study of the utilisation of cash credit and overdraft limits during the recent years. The Group further decided to discuss the issues with a representative cross-section of bankers, asso-

@ Since appointed as Chief Officer.

* Since appointed as General Manager.

ciations of borrowers and experts in the field before formulating its views on the terms of reference.

Collection of data and instructions to banks

1.4 Accordingly, the Group made arrangements to collect data available in BSR and CAS returns. It was decided to obtain from banks on an urgent basis the CAS data relating to March 1979 to see how far the banks have been able to implement the instructions contained in the Governor's circular dated 30th November 1978. The major banks were also advised to furnish the reasons for their inability to comply with the above instructions. Certain information on the basis of a sample study of the utilisation of cash credit/overdraft limits during the years 1977, 1978 and upto end-March 1979 was also called for from them. A copy of the circular dated 9th April 1979 issued to the major banks is given in Appendix II.

Discussions held

1.5 In accordance with the decision taken at the first meeting, the Group held discussions at Bombay, Calcutta, Madras, New Delhi, Ahmedabad and Bangalore and the various issues referred to the Group were discussed with the bankers, industry and trade interests and experts in the field of banking and credit. During these meetings, the members discussed with the participants the various issues germane to the terms of reference of the Working Group. Some of the participants have submitted memoranda on the subject to the Working Group. A list of the persons and organisations whom the Group invited for discussions as well as those who have conveyed their views in writing to the Group is furnished in Appendix III.

Interim Report

1.6 As the Group had not received from a number of banks the results of the sample study which they were asked to make as also the other information called for from them, it was not possible for it to study in depth all the terms of reference referred to it and finalise the recommendations before the due date (15th May 1979) originally fixed for submission of its report. An interim Report was, therefore, submitted by the middle of May 1979 on the basis of the information already gathered and the Group requested the Reserve Bank of India for extension of time (upto end-August 1979) for submission of the final Report, which was granted.

Acknowledgements

1.7 The Group is grateful to all persons and organisations listed in Appendix III for discussing the issues arising out of the terms of reference with it and also for furnishing memoranda giving their views. The Group wishes to express its thanks to Kum. Nalini K. Ambegaokar, Shri G.S. Caberwal, Shri S.V. Raghavan and Shri M.K. Desai of the Reserve Bank of India for attending some of its meetings. The Group also acknowledges the valuable assistance received by it from Shri W.S. Saraf and Shri V.V. Ghalsasi, both of the Reserve Bank of India in compilation of statistical information. Last but not the least, the Group is extremely grateful to the Secretariat comprising its Member-Secretary (Shri M.L. Inasu), Shri R.A. Nilakantan, Shri Y.D. Bajpai and Shri M.V. Murkunde of the Reserve Bank of India for organising the work, arranging the meetings and drafting the minutes of various meetings as well as the Report. The Group particularly places on record its deep appreciation of the untiring zeal and devotion with which the Member-Secretary performed his functions.

CHAPTER II

Compliance by banks with the credit policy instructions of the Reserve Bank—end-November 1978—end-March 1979

2.1 The cash credit system has been the predominant form of lending in India, accounting for over half of the total credit of banks. According to BSR data (which cover accounts with individual credit limits of more than Rs 10,000) cash credits and overdrafts together formed around 57 per cent of the total credit limits sanctioned by scheduled banks in June 1973. In June 1977, the proportion was lower at 51 per cent. The decline was on account of an increase in the share of term loans and bills in the total limits.

Extent of the use of cash credit

2.2 The cash credit system is prevalent amongst all sectors of borrowers. Its use is not, as is sometimes believed, confined to large borrowers only. The following table, drawn from the BSR, which relates to cash credit/overdrafts and total borrowings from banks as at the end of June 1977 in different size ranges illustrates this point:

Credit limit range	Credit limits (Rs. in crores)		Column 1 as percent of col. 2
	Cash credit/ overdraft	All facilities	
	(1)	(2)	(3)
Above Rs 10.000 and upto Rs. 1 lakh ..	988 (10.4)	2256 (12.2)	43.8
,, Rs. 1 lakh and upto Rs. 5 lakhs ..	1077 (11.3)	2091 (11.4)	51.5
,, Rs. 5 lakhs and upto Rs. 10 lakhs ..	492 (5.2)	1091 (5.9)	45.1
,, Rs 10 lakhs and upto Rs. 25 lakhs ..	746 (7.9)	1744 (9.4)	42.8
,, Rs. 25 lakhs and upto Rs. 50 lakhs	705 (7.4)	1591 (8.6)	44.3
,, Rs. 50 lakhs and upto Rs. 1 crore ..	887 (9.3)	1774 (9.6)	50.0
,, Rs. 1 crore and upto Rs. 5 crores ..	1872 (19.7)	3146 (17.0)	59.5
,, Rs. 5 crores and upto Rs. 10 crores	543 (5.7)	822 (4.4)	66.1
Above Rs. 10 crores	2189 (23.1)	3986 (21.5)	54.9
Total	9499 (100.0)	18501 (100.0)	51.3

(Figures in brackets indicate percentages to the total)

The distribution of cash credit/overdrafts among different categories of borrowers is also to a large extent similar to the distribution of total credit limits.

Ineffectiveness of credit regulatory measures—Role of cash credit system

2.3 Under the cash credit system, limits are fixed according to the maximum requirements of individual borrowers and drawals made according to the needs at any point of time. Hence, the existence of an unutilised portion in the credit limits is a normal feature of the system. In times of credit restraint, the unutilised portion is a source of potential credit expansion. On several occasions in the past, banks have expressed their inability to implement effectively short-term measures of credit restraint in view of the existing system of cash credit arrrangements under which there is a sizeable gap of unutilised limit. In the situation obtaining in end-November 1978—end-March 1979, the advances exceeded the level of 40 per cent specified by the Reserve Bank for incremental (non-food) credit-deposit ratio. The Group considered it necessary to examine the extent to which the credit expansion could be attributed to the weakness of the cash credit system. Accordingly, information on this point was collected from major banks; this was also discussed in the course of various meetings with representatives of banks at functional level responsible for implementation of this instruction. The points which emerged from this are as follows:

(*i*) During December 1978—January 1979, on account of the agitation of bank employees and the difficulties in clearing, the banks could not collect bills and cheques and credit the proceeds to the accounts of their customers. This in itself would have increased the balances in the accounts. Moreover, some of the constituents had to be accommodated against such instruments to provide them with funds for their day-to-day operations. In addition, probably apprehending a worsening of the industrial relations situation in the banks, some of the constituents might have drawn down the available funds in their cash credit acccounts.

(*ii*) Before the instructions regarding credit restraint could be communicated to the branches by the Head Offices of the banks, the news had already appeared in the press. Most of the borrowers had, therefore, time to draw from their accounts before the freeze could take place. Some of the banks have reported in this connection that the bulk of the increase during end-November 1978—end-March 1979 occurred during December 1978 itself.

(*iii*) The credit restrictions were imposed at a time when there was a rise in the demand for funds to meet the busy season requirements. Moreover, this period also coincided with the demand for funds by certain seasonal industries like sugar. In fact, the Reserve Bank itself had to make certain relaxations during this period in respect of credit to the sugar industry.

(*iv*) The quarter October-December is usually a period of rapid expansion in deposits whereas the quarter January-March is a period of relatively poor deposit growth. The aggregate deposits which had registered a steep increase of Rs 1494 crores in December 1978, declined by Rs 187 crores in January 1979. December is also a month in which, owing to interest application and other closing adjustments, advances usually show an increase. In a situation of relatively slower growth of deposits and greater demand for funds, the restriction on the incremental credit deposit ratio was hard to conform to.

(*v*) Out of the additional deposits accruing to the banking system, at present about 50 per cent has to be provided for maintenance of liquid assets including ten per cent of the additional deposits which are currently impounded. The available funds for advances are thus restricted to about 50 per cent of the incremental deposits. Even out of these funds available for advances, about one half has to be earmarked for priority sectors, exports and food credit and in these spheres the banks have very little scope for applying credit restraint. The credit restraint has, therefore, to be necessarily confined to the residual sectors consisting of medium and large industries and traders accounting for about 25 per cent of the additional deposits. Some of the units in these sectors are sick and the banks have little discretion in the matter of extending credit to them. Banks have also to satisfy themselves in individual cases whether credit restrictions would be justified having regard to production needs. In effect, the scope for exercising credit restraint in relation to additional deposits is rather narrow.

(*vi*) Part of the increase in advances during the period was due to the inability of banks to prevent disbursement of funds out of limits and term loans sanctioned earlier.

(*vii*) Some of the banks have said that the uniform application of the formula of 40 per cent for incremental credit (non-food)—deposit ratio adversely affected those banks whose credit-deposit ratio was low as compared to those whose credit-deposit ratio was high.

On behalf of industries, it has been stated that they plan their production in advance in consultation with banks and after obtaining sanction of credit limits for the projected planned level of production. It would not be possible for the borrowing community to fall in line with the credit restraint policy immediately; some time should be given to them to make necessary alterations in their planned programme.

Monitoring system in banks

2.4 Most of the above reasons for banks' inability to comply with the instructions of the Reserve Bank regarding incremental (non-food) credit-deposit ratio have some validity. In view of what has been stated in paragraph 2.3 (*i*) and (*ii*) above, it is also likely that to some extent at least the cash credit system of lending may have contributed to the banks' failure to comply with these instructions. However, from the information furnished by banks and the subsequent scrutiny carried out by the Regional Offices of the Reserve Bank in June-July 1979, it has been observed that there are some inherent weaknesses in the information and monitoring systems in the banks themselves, which also were partly responsible for the inability of banks to comply with these instructions. These are:

(*a*) There has to be a minimum time lag between the formulation of policy and its actual implementation. But some of the banks took inordinately long time to communicate the instructions of the Reserve Bank to its operational functionaries who have to actually implement the instructions. Out of the 27 banks from whom information was called for, only 15 had issued instructions to their branches by the middle of December 1978 and the rest issued such instructions only after the second week and some of them

even after a delay of a month or more. Many of the banks also did not have a system of communicating the instructions to the key branches expeditiously. The quality of the instructions issued to branches also differed from bank to bank. Some of them spelt out in detail how the instructions of the Reserve Bank were to be implemented while others confined themselves to general instructions for containing credit.

(*b*) Communication by itself cannot ensure compliance with the instructions. It has to be supported by adequate arrangements for getting feed-back information as well as monitoring of such information with a view to formulating further operational strategies. Here again, only some of the banks do have a fairly good information/monitoring system and, by and large, these banks were comparatively more successful in bringing down the incremental (non-food) credit-deposit ratio than the others.

(*c*) While banks have been able to furnish data regarding sectoral increases in their credit, most of them have not made any detailed study of the larger accounts in the industrial and trading sectors where the increases took place. Only a few banks do have a continuous review system of larger accounts. Even though the Reserve Bank instructed banks on the 16th March 1979 to review all the advances with credit limits of Rs 50 lakhs and above, the scrutiny conducted by the Regional Offices of the Department of Banking Operations & Development, Reserve Bank of India in June-July 1979 revealed that barring a few, the majority of the banks did not undertake such a review even by June 1979.

Need for strengthening the information and monitoring system

2.5 There is obviously a need for strengthening the information and monitoring systems in banks for medium and large scale advances and the Group's recommendations in this regard are given in Chapter VII.

CHAPTER III

Gap between the sanctioned limit and utilisation

Sources for ascertaining gap between sanctioned limits and utilisation

3.1 According to the terms of reference, the Group has been asked to review the gap between the sanctioned limits and utilisation. The sources available for such a study were mainly the Basic Statistical Returns (BSR) obtained by the Reserve Bank from the banks; but the data contained therein were available only upto June 1977. With a view to assessing the aggregate credit limits and the extent of utilisation by large borrowers, the Credit Authorisation Division of the Reserve Bank has been obtaining some data from the banks in a monthly return (Form 'A') in respect of borrowers enjoying credit limits of Rs 1 crore and above each (CAS Returns). These borrowers account for a little under two-fifths of the aggregate non-food credit of the banking system and the data were readily available upto December 1978.* With a view to extending the study upto the last Friday of March 1979, banks were specially requested to submit the returns for March 1979 expeditiously as mentioned in Chapter 1.4. Most of the banks have co-operated and submitted the data in time. The observations contained in the following paragraphs are mainly based on the above two sources. The statements prepared on the basis of the above data are given in Appendix IV (Statements 1 to 7).

Extent of the use of cash credit system in the total lending

3.2 According to the BSR data which covered individual credit limits of more than Rs 10,000 (Statement No.1), the cash credit/overdraft limits accounted for 57.2 per cent of the total credit limits in June 1973 and 51.4 per cent of the total in June 1977. The amount outstanding in these two categories of lending was 58.1 per cent of the total outstandings in June 1973 and 51.4 per cent in June 1977.

3.3 According to the CAS returns relating to the borrowers enjoying credit limits of Rs 1 crore and above (Statement No.2), the cash credit/overdraft limits (and also demand loans, for which no separate data were available but the proportion of which in this group was known to be low) accounted for 66.4 per cent of all the facilities extended to this group in March 1977. The share came down to 63.7 per cent in March 1979. Corresponding amount outstanding was 67 per cent in March 1977 and 64.1 per cent in March 1979. It may be observed from the above data that for large borrowers, the share of cash credits and overdrafts in the total lending system in relation to the total limits as well as outstandings has been more or less stable during the last few years around two-thirds of the total lending to this group of borrowers.

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* As at the end of December 1978, the parties covered through the return in Form 'A' totalled 1876 covering 10464 accounts, of which the number of cash credit accounts was 4932. The rest of the accounts represented other facilities like inland and foreign bills, packing credit, term loans, etc.

3.4 Statement No. 1 giving the BSR data for 1973 and 1977 shows that the extent of utilisation of the cash credit and overdraft limits in June 1973 was 56.2 per cent. It increased in June 1977 to 65.3 per cent. According to the CAS returns, while the utilisation of the cash credit overdraft and demand loans was 62.8 per cent in March 1977, it increased to 64.3 per cent in March 1979. Thus, the gap between sanctioned limits and utilisation, in the aggregate, can be roughly stated to be one-third of the sanctioned limit. This, however, does not mean that in each individual account the gap is one-third of the sanctioned limit. As a matter of fact, in individual accounts the probability is that at some points of time there may not be any gap at all and the limit may be fully utilised. The extent of the gap as calculated above is essentially a macro-level concept.

Extent of utilisation

3.5 As will be seen from the BSR data presented in Statement No. 3, the utilisation of the cash credit limits in different industry groups shows variations depending upon the seasonal characteristics of the industry. This trend is also reflected by the statement prepared on the basis of CAS data (Statement No. 4) which further indicates that the time for peak utilisation of the limit differs from industry to industry.

Industrywise utilisation

3.6 It is further observed that the utilisation in some groups has been consistently low, e.g., petroleum, cement, plantations, electricity generation and supply, etc., whereas some of the industries show consistently high utilisation, e.g., paper and paper products, leather and leather products, heavy and light engineering, transport equipments, etc. Seasonal fluctuations were mostly noted in the case of agricultural finance, plantations, coal and iron ore mining, sugar, edible oil and vanaspati, tobacco, fertilizer production and electrical machinery.

3.7 Statement No.5 shows the utilisation of the public and private sector units reported in CAS returns. By and large, utilisation of the limits by the public sector (broadly ranging between 50 and 55 per cent) has been consistently lower than that of the private sector (around 70 per cent). The public sector units have also been consistently using their limits to a higher extent in 1978-79 than during 1977-78 . More or less a similar trend is observed in the private sector also.

Sectorwise utilisation

3.8 It will be seen from Statement No. 6 (BSR data) that as at the end of June 1976 and 1977 utilisation of credit limits was high (around 70 per cent) in the case of very large borrowers (with limits over Rs 10 crores) and very small borrowers. According to CAS data also (Statement No. 7), large borrowers (with limits over Rs 10 crores) reported high utilisation of about 70 per cent in December 1978.

Sizewise classification

3.9 As indicated in paragraph 3.4, the cash credit limits in the aggregate were utilised to the extent of about two-thirds, although the extent of utilisation varied from quarter to quarter, depending mainly upon the seasonal characteristics of the industry. The phenomenon of the gap between the sanctioned limits and the utilisation thereof is not unique to Indian banking conditions. In countries like the U.K., where the overdraft system is in force, such gap is very much in existence. In this con-

Gap not unique to India

text, an extract from the "Evidence by the Committee of London Clearing Banks to the Committee to Review the Functioning of Financial Institutions (1978)" is given below:

> "The clearing banks respond to customers' requests for finance by agreeing borrowing facilities; once a bank has arranged a facility it is under a firm commitment to make the money available. However, 'drawdown' (or the actual use made of the facility) is dependent entirely on the customer. Loan arrangements tend to be available for drawing within a specified period, which can be extended if there has been any delay in a project; overdraft facilities by their very nature fluctuate according to the customer's day-to-day needs. Thus, of the £36,381 million of facilities available in May 1977, only 60 per cent were actually taken up.......... On 18 May 1977, the clearing bank groups' total overdraft commitments (excluding loan accounts) to customers amounted to £ 18,675 million, but on that date actual borrowing under these facilities was only 48 per cent of the amount available.........."

Reasons for the gap—Peak levels do not coincide

3.10 As the existence of the gap in the cash credit system is a reality, the Group considered it necessary to identify the reasons for the gap. According to the 'Evidence by the London Clearing Banks' referred to above, the gap exists—

> "Because the peak borrowing requirements of individual customers occur at different times, the clearing banks' customers as a whole would never take up all their facilities at the same time.........."

This reasoning would hold good for the cash credit system in India also. Presently, the credit limits to a borrower are fixed on the basis of his peak level requirements. As the peak levels of the borrowers, belonging to different sectors of the industry would not coincide, there is bound to be a gap between the limit and utilisation at all points of time; the extent of the gap may, however, vary depending upon the advances pattern and economic conditions. For instance, all the industries would not be able to maintain the maximum projected level of production at the same time and hence they would not be utilising the full limits also at the same time. Psychologically too, the Indian banker has been trained to view with approval large fluctuations in the credit limit. On the other hand, full utilisation of the limit at all points of time is considered as a drawback casting reflections on the financial soundness of the borrower.

Reasons for the gap—View of industry—lead time for sanction and delays

3.11 In the course of the discussions with the associations of industry and trade, their representatives brought forth several other reasons for the existence of the gap. One of the most important reasons according to them, which has been impressed upon the Working Group more than once during the discussions, is that there is considerable time lag between the date of application to a bank for credit limit and the date of sanction. This delay is to a large extent built into the system of sanctioning of advances by banks. An application for a larger advance has to be initially processed by the branch concerned and then sent to

the controlling office of the branch. It is finally submitted to the Central Office which has to place it before the Board and where necessary a reference has to be made to the Reserve Bank of India for authorisation under the Credit Authorisation Scheme, thus adding another tier to the sanctioning process. At every stage of scrutiny, some time would necessarily be involved and cumulatively, therefore, the lead time for sanction of a large proposal of the medium and large scale industry is usually several months. The representatives of the borrowers have plainly admitted that because of the substantial lead time involved, there is a tendency on their part to inflate the limit applied for to provide for a cushion for such time lags. In the first instance, the price level at the time of sanction may be higher than the price level at the time of application. Secondly, as the borrowers apprehend such time lags in the sanction of applications for temporary increases in limits, necessitated by urgent demand for funds, they try to procure in the first instance itself as much credit as possible. Under the cash credit system presently in vogue, they do not lose anything by resorting to such inflated applications, as it does not cost them anything to get a larger limit sanctioned. On the other hand, it has a definite advantage to them, as it will obviate the need for approaching the banks for additional limits as and when the necessity for such funds arises. Because of these two factors alone, if nothing else, the limits applied for by the borrowers are often much in excess of their actual requirements. The maximum limits so sanctioned may be utilised by individual borrowers for short durations, but for the rest of the time they may not be so fully utilised. This partially accounts for the gap between the sanctioned limit and utilisation.

Cushion for imponderables in the economy

3.12 A second reason for the existence of the gap adduced during the discussions is that in the Indian economy at present there are various imponderables like power cuts, transport bottlenecks, changes in import policy including restrictions on imports, bunching of imports, unilateral and sudden changes in prices by canalising agencies, government policies regarding stocking of raw materials and release of finished goods, payment to suppliers and labour, payments like bonus, budget uncertainties, *et al.* With the best of projection techniques, the industry is not in a position to assess the impact of these imponderables on their fund requirements. At the same time the fact remains that these contingencies do create a need for funds when they happen. As the borrower cannot make any correct assessment of the amount of funds required to meet such imponderables, he builds in the application a liberal cushion for such factors, again inflating the quantum of the limit applied for. As the need for funds required for meeting such contingencies arises only when they occur, the normal utilisation is much below the limit sanctioned.

Unusual deposits and withdrawals

3.13 The third reason given by the borrowers for the gap is that the deposits made by them in their cash credit accounts from sale proceeds represent not only cost of production but also the element of profit and depreciation. These amounts could be quite substantial in the case of large borrowers. At times extraneous items like public deposits and unutilised term finance raised for capital expenditure are also put through these accounts. These large deposits do widen the gap between the sanctioned limit and utilisation. Similarly, when funds are drawn for purposes of dividend and tax payments, acquisition of capital assets, etc., the gap may be

substantially narrowed. Such large payments, in the opinion of borrowers, should not be deemed to be pre-emption of credit.

Imperfectness of assessment techniques

3.14 Still another reason given for the gap is the imperfectness of the techniques of assessment adopted by the banks. Although the Tandon Committee have given an objective technique for assessment of the working capital requirements, the whole exercise is based on projections; projections of sales, of the acceptable levels of inventory to support the anticipated level of production and projections of other current assets and current liabilities. These projections by their very nature cannot be perfect. Even slight alterations in the forecasts and marginal deviations from the acceptable norms of inventory cumulatively can affect the quantum of the limits substantially. Both the borrowers and the banks try to err on the safe side with the result that in fixing the limit a cushion in favour of the borrower is usually built in.

Significance of the gap

3.15 The phenomenon of the gap and the reasons therefor assume considerable significance, as the unutilised limits create potential liquidity in the economy. "Decisions to spend on goods and services—the decisions that determine the level of total demand—are influenced by the liquidity of spenders........ spending is not limited by the amount of money in existence but it is related to the amount of money people think they can get hold of".* The use of the unutilised limits is at the volition of the borrower. Hence as soon as any move of credit restraint is apprehended, he tends to pre-empt credit by utilising the unutilised limit available to him, whether he requires the funds immediately or not. This aggravates the situation which necessitated the credit restraint policy of the authorities.

Limitations to draw-down—Quarterly statements and Drawing Power

3.16 The resort to unutilised cash credit limits is subject to two important provisions built in the cash credit system as it is operated today. Firstly, the borrowers, especially the larger borrowers, have to submit quarterly statements and drawings are permitted on the basis of this information. Secondly, the borrower cannot draw more than the amount equivalent to the value of security less prescribed margin, *i.e.*, drawing power. Thus, technically, the borrower cannot utilise the undrawn limit without question, unless the bank is satisfied about the genuineness of his needs. The quarterly information system, an innovation brought in by the Tandon Committee, has not, however, taken roots firmly yet and it is difficult for the banks, in practice, to refuse to pay a cheque presented in clearing if the drawing is within the sanctioned limit and the drawing power. The restriction imposed by the drawing power is also in actual practice found to be of little significance because it is comparatively easy for a large borrower to acquire additional chargeable current assets, without paying for them in cash immediately and thus increase the drawing power. Moreover, it is also noticed that in the case of many large borrowers, the drawing power is not significantly less than the limit sanctioned. The information furnished by major banks, in reply to the Group's circular letter dated the 9th April 1979 (*vide* para 1.4) indicates the following position :

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* Report of the Radcliffe Committee

Borrowers who were given fresh/additional working capital limits of Rs. 50 lakhs and above during the period end-November 1978 to end-March 1979

No. of reported accounts	**212**
Public sector	45
Co-operative sector	7
Private sector	160
	212

(In crores of rupees)

Facility (1)	Credit limits (2)	Drawing power (3)	Amount outstanding (4)
I—Position as at the end of November 1978			
Cash credit	458.04	342.84	322.42
Other working capital limits	184.87		108.89
Total	**642.91**		**431.31**
II—Position as at the end of March 1979			
Cash credit	586.43	430.67	383.78
Other working capital limits	275.40		159.24
Total	**861.83**		**543.02**
III—Net increase			
Cash credit	128.39	87.83	61.36
Other working capital limits	90.53		50.35
Total	**218.92**		**111.71**

It will be seen from the above data that the drawing power in end-November 1978 in the cash credit accounts was about 75 per cent of the sanctioned limits. In end-March 1979, the drawing power at 73 per cent of the sanctioned limits was not significantly lower.

3.17 The above trend is also confirmed by the sample study conducted by banks in terms of our letter dated the 9th April 1979 (*vide* para 1.4). Confining the analysis to accounts having limits of Rs 1 crore and above, where the coverage has been satisfactory, it is found that of the 505 accounts reported, the drawing power and sanctioned limits were equal in 278 accounts in end-November 1978 and 284 accounts in end-March 1979. Looking at the data from another angle, in the total 505 accounts reported, the drawing power in end-November 1978 constituted 88 per cent of the sanctioned limits and in end-March 1979, 91 per cent.

3.18 In the above 505 accounts the gap between the sanctioned limit and the balance in end-November 1978 was 39 per cent ; in end-March 1979, the gap was 41 per cent. Similarly, the gap between the drawing power and the balance in end-November 1978 was 31 per cent and in end-March 1979, such gap was 35 per cent. The above data would go to show that the gap, whether it is based on the difference between sanctioned limit and utilisation or between drawing power and utilisation, is substantial and the drawing power as such does not have much influence in the utilisation of the gap.

Study of utilisation of gap—during end-November 1978-end-March 1979

3.19 Though the gap between the sanctioned limit and utilisation is substantial and the possibility of its misuse during periods of credit restraint cannot be ruled out, there was no empirical evidence to show that the gap was so misutilised. In order to study this aspect, as indicated in Chapter 1.4, the Group requested the major 27 banks to furnish certain data. The data given by the banks have certain limitations. The samples selected by the banks may not have been on a uniform scientific basis. Part of the study relates to a short span of time, *i.e.*, end-November 1978—end-March 1979. Even subject to the above limitations the sample studies made by the banks give certain indications of the trend of increase in credit extended during end-November 1978 and end-March 1979 and the extent of utilisation of cash credit and allied limits as well as in other limits. On the basis of the above data as well as the data in Form 'A' under CAS obtained from banks, an attempt has been made to see whether the increase in the advances that took place during the period end-November 1978—end-March 1979 was mainly due to the draw-down of the gap in the cash credit system.

CAS Data—Increase in credit during end-November 1978 and end-March 1979

3.20 Comparing the data reported in Form 'A' under CAS of all banks for end-March 1979 with those for end-November 1978 the following picture emerges :

(In crores of rupees)

	Cash credit/ overdraft and demand loans	Other facilities (packing credit, inland and foreign bills, term loans and bills discounted under IDBI scheme)	Total
	(1)	(2)	(3)
		End-November 1978	
Limits sanctioned	5516	3019	8535
Percentage to total	(64.6)	(35.4)	(100.0)
Outstandings	3417	1837	5254
Percentage to total	(65.0)	(35.0)	(100.0)
		End-March 1979	
Limits sanctioned	5733	3267	9000
Percentage to total	(63.7)	(36.3)	(100.0)
Outstandings	3688	2065	5753
Percentage to total	(64.1)	(35.9)	(100.0)
Increase in limits sanctioned	217	248	465
Percentage increase in limits sanctioned	3.9	8.2	5.4
Increase in outstandings	271	228	499
Percentage increase in outstandings	7.9	12.4	9.5

Out of total increase in credit limits at Rs 465 crores, the increase in cash credits, overdrafts and demand loans was only Rs 217 crores and the balance of the increase took place in 'other' limits. The total increase in outstandings of the parties reported in Form 'A' during the period end-November 1978—end-March 1979 is to the extent of Rs 499 crores, of which the increase in cash credit/overdraft and demand loan would be Rs 271 crores or 54 per cent of the increase. The rest of the increase is in other limits. The percentage of utilisation of sanctioned limits in cash credit/overdraft and demand loan as at end-March 1979 was 64 per cent as against 62 per cent as at the end of November 1978. The percentages of utilisation in 'other' limits for the corresponding periods were 63 and 61. Obviously, the use of the unutilised gap has been more or less of the same degree in 'cash credits, overdrafts and demand loans' and in 'other' limits. The above trend is also revealed by the data regarding fresh/additional working capital limits of Rs 50 lakhs and above granted during end-November 1978 and end-March 1979 called for from the major banks (*vide* statement given in paragraph 3.16). Of the total increase in limits of Rs 219 crores reported during the period, an increase of Rs 128 crores took place in cash credit limits and Rs 91 crores in other limits. Similarly, of the total increase of Rs 112 crores in outstandings during the period the increase in cash credit accounts was Rs 61 crores while the increase in other limits was Rs 51 crores. Thus, the increase in credit that took place during the period covered by the study was partly due to large fresh and additional limits sanctioned during the period and not exclusively due to an increase in the existing cash credit limits. Moreover, the increase in credit was not confined to cash credit limits, but was substantially due to 'other limits' as well.

Sample study—Increase in credit during end-November 1978 and end-March 1979

3.21 The sector-wise increase in credit during the period end-November 1978 and end-March 1979 in respect of the major banks covered by the sample study which furnished the information was as follows :

(In crores of rupees)

Priority sectors	494
Exports	140
Other sectors	638
Total	1272

Nearly 50 per cent of the increase was in priority and preferred sectors, where the banks did not make any conscious efforts to curb expansion of credit.

3.22 The consolidated data furnished by the banks in respect of the accounts covered by the sample study are given below :

Total No. of accounts reported	1342
Accounts with limits between Rs. 10 lakhs and Rs. 1 crore	837
Accounts with limits over Rs. 1 crore	505

(In crores of rupees)

	Sanctioned limit	Drawing power	Balance	% of utilisation
March 1977	1868	1654	1175	63
September 1977	1963	1726	1224	62
March 1978	2039	1871	1228	60
September 1978	2156	1975	1315	61
November 1978	2257	1974	1401	62
March 1979	2321	2064	1410	61

Increase in balances of March 1979 over November 1978 } = Rs. 9 crores

The data relating to advances with cash credit/overdraft limits between Rs 10 lakhs and Rs 1 crore are given below :

	End-November 1978	End-March 1979
Limits sanctioned	287	298
Drawing power	233	230
Balance outstanding	198	219
% of utilisation	69%	73%

Increase in balances of March 1979 over November 1978 } = Rs. 21 crores

The data relating to accounts having cash credit/overdraft limits of Rs 1 crore and above reported to the Group (where the coverage is better than the group of accounts with limits between Rs 10 lakhs and Rs 1 crore) have been studied in detail. Out of the 505 accounts, 281 accounts showed an increase in balances during end-November 1978 and end-March 1979. Their position is as follows :

(In crores of rupees)

	End-November 1978	End-March 1979
Limits sanctioned	878	935
Drawing power	734	860
Balance outstanding	533	750
Percentage of utilisation	61%	80%

In the remaining 224 accounts there has not been any increase in the outstandings. In most of them the balances have come down. Their position is as follows :

(In crores of rupees)

	End-November 1978	End-March 1979
Limits sanctioned	1092	1088
Drawing power	1007	974
Balance outstanding	670	441
Percentage of utilisation	61%	41%

The consolidated position of all the 505 accounts having limits of Rs. 1 crore and above is as follows :

(In crores of rupees)

	End-November 1978	End-March 1979
Limits sanctioned	1970	2023
Drawing power	1741	1834
Balance outstanding	1203	1191
Percentage of utilisation	61%	59%

3.23 It will be observed from the above data that the increase in balances during the period end - November 1978 and end-March 1979 occurred only in 281 accounts whereas there was no increase at all, although there was adequate sanctioned limit and drawing power in 224 accounts. The percentage of utilisation as at the end of November 1978 and end of March 1979 in accounts, which had shown an increase during the period, had considerably increased from 61 per cent to 80 per cent, but in accounts which do not show any increase, the percentage of utilisation came down from 61 per cent to 41 per cent. The consolidated position shows only a two percentage point change in the utilisation. Further, out of the 281 accounts which reported increases, in 69 accounts, the increases were of the order of Rs 1 crore and above and total increase in these 69 accounts was to the tune of Rs. 147 crores. Similarly, in the 224 accounts which did not show an increase, 19 accounts showed an aggregate decrease of Rs 141 crores. In 1 account alone the decrease was of the order of Rs 45 crores. Some of the decreases would have been accounted for by a corresponding increase in bills/cheques purchase which would not be reflected in the data furnished above. Because of the inclusion of such large accounts which showed very heavy fluctuations and as the samples selected by banks may not have been on a uniform scientific basis, the data presented by banks may be vitiated to some extent.

3.24 Despite these limitations, the following indicative conclusions drawn from the above study would appear reasonable :

Conclusions derived from the data relating to sample study, etc.

(*a*) During the period of credit restraint (end-November 1978—end-March 1979) in several cash credit accounts, an increase has taken place which is disproportionate to the increase in sanctioned limits during the period. Obviously, the unutilised gaps in these cash credit/overdraft accounts have been drawn to some extent during this period.

(*b*) Although in several accounts the unutilised gaps have been so utilised, there are also several accounts in which the gap has not been so utilised at all, though the sanctioned limit and the drawing power had adequate potential for such drawings.

(*c*) The increase that has taken place in the total advances of the banking system during the period end-November 1978 and end-March 1979 is not confined to the cash credit/overdraft system as such but substantial increases have also taken place in bills, loans, packing credit, etc.

(*d*) In the larger account groups, there are several accounts where the fluctuations even during short periods are substantial.

(*e*) Most of the banks have taken certain steps to comply with the instructions of the Reserve Bank to confine their incremental (non-food) credit-deposit ratio to 40 per cent and their attention would have been naturally concentrated on larger accounts. These measures have obviously yielded results ; for while there has been a nominal decrease in the cash credit/overdraft balances of the larger accounts covered by the study there has been a significant rise even in the small proportion of the smaller accounts (with limits between Rs. 10 lakhs and Rs 1 crore) covered by the study.

(*f*) The above conclusions apply both for private sector and public sector units. As a matter of fact, the unused gap in the public sector units is much more than that in the private sector.

3.25 It has not been possible for the Group to identify whether in cases where the gap has been utilised, there has been any deliberate attempt at pre-emption of credit. The very fact that gap has not been utilised at all in several cases would go to show that the use of the gap in cash credit during times of credit restraint as a reason for increase in credit can at best be only partly true.

CHAPTER IV

Advantages and disadvantages of different styles of lending—Recommended lending system

4.1 One of the terms of reference of the Group is to suggest modifications in the cash credit system and/or to suggest alternative types of credit facilities. In this Chapter, the Group has examined the various types of credit facilities prevalent in the banking system and the existing system of lending in the country. The system of lending recommended by the Group is also broadly outlined.

Introductory remarks

4.2 It may be mentioned at the outset that a view has been forcefully brought before the Group that for purposes of credit control and regulation, style or form in which credit is extended, *viz.*, cash credit/overdraft, bill or loan is not as much significant as the aggregates of the lending and the purpose for which credit is used. While conceding the validity of this argument, the Group feels that the style of credit has some influence on credit management and credit regulation. It has also a positive impact on the follow-up of credit at micro-level.

The style of credit vis-a-vis credit control

4.3 The three main systems of financing working capital requirements that we come across in the banking system are cash credit and/or overdraft, loans and bills. All the three systems are prevalent in different parts of the world. Overdrafts (which are more or less akin to cash credit system in India) are the most common type of corporate line of credit in Netherlands, Switzerland, Italy and U. K. and used fairly extensively in Sweden, Germany and France. In U.S.A. and Japan, term loans for short periods are the chief form of short-term finance. It is understood that this type of financing is usually accompanied by maintenance of compensating balances. In these two countries overdrafts are virtually non-existent. The bill system is extensively used particularly for financing small and medium-sized firm in France and Italy. It is also common in Japan.

Systems in other countries

4.4 Any system of lending should have the following basic attributes :

Attributes of a good lending system

—It should be amenable to rational management of funds by banks,

—It should enable banks to relate credit limits to increases in output or other productive activities,

—It should be amenable to credit control measures by the central banking authorities,

—It should be operationally convenient to banks as well as customers and the cost of administering the system should not be a burden either on the banks or on the borrowers.

4.5 Seen from the above angles, the three main systems of financing, namely, cash credit/overdraft, loans and bills have all certain advantages and drawbacks.

Cash Credit System

In the initial stages when the banks were mainly financing the requirements of trade and seasonal industries and the emphasis was on security rather than purpose, the cash credit system was found to be convenient both for the borrowers and the banks. In the context of the considerable changes in the pattern of lending particularly since nationalisation, the system has been found to be wanting in several respects. Its weaknesses have been highlighted by various Committees in the past including the Dehejia Study Group set up in 1968, the Narasimham Study Group on Bills constituted by the Reserve Bank in 1970 and by the Tandon Committee appointed by the Reserve Bank in 1974. Under the cash credit system, it is argued, the level of advances in a bank is determined not by how much the banker can lend at a particular time, but the borrower's decision to borrow at that time. The system permits the borrower to keep his surplus funds in the bank and also enables him to draw funds when required within the prescribed limits without any restrictions. While this facility has some advantages to the borrower, it also relieves him of the responsibility of making any conscious effort to manage his cash resources. This problem is shifted to banks. By its very nature, therefore, the system does not encourage proper management of funds by banks and control of the credit portfolio becomes difficult.

4.6 The practice of fixing limit under the cash credit system also results in fixing larger limits than is required for most part of the year. This affords an opportunity to the borrowers for misutilisation of the unutilised gap in times of credit restraint. Because of the importance attached to the nature and value of the security under the system, it accentuates to some extent inflationary and deflationary pressures. For instance, if the price level rises the value of the security held also rises and more credit will be required (and also will be available as the value of security increases) to hold the same quantity of inventories. The increase in bank credit further influences prices and the process continues. Again, on account of the stress on security aspect, there is no concious effort on the part of banks to verify the end use of funds. This facilitates diversion of funds for unapproved purposes and the lending banker becomes aware of it only after a considerable lapse of time. These characteristics of cash credit, it is stated, affect the efficacy of credit planning and regulation of credit by the central banking authority.

4.7 The cash credit system, according to some, is also not conducive to efficiency. The efficient manufacturer will get less finance because his inventory and receivable level will be less than that of an inefficient producer. Similarly, a producer who withholds his output to take advantage of the rising market is more favoured under the system than the one who sells out his output and reduces his inventory.

4.8 The limits under the cash credit system are normally reviewed on an annual basis. This in itself is a long period for review having regard to the short-term nature of the advance. More often than not, even the annual reviews are delayed. In the case of loans a review is built into the system and such review will be necessarily done while renewing the loan. In the case of bill finance

there is less need for such a review as the retirement or return of the bill itself will be known in a short period.

4.9 Despite the above disadvantages, the cash credit system has been in vogue in the country for a long time. This is mainly because of its flexibility. It enables the borrowers to recycle the funds quite efficiently and they do not have to keep surplus idle funds. The anxiety to minimise interest charges prompts the borrower to route all his cash accruals through the account and keep the drawings at the minimum required level. This ensures lesser cost of funds and facilitates a better turnover of funds for the banks as well. The flexibility of the system also takes care of temporary requirements of funds by the borrowers without undue delay, without detailed negotiations and without creating any problem of documentation and security charging.

4.10 In addition, it is stated, the system is operationally convenient for the customers who can route all their transactions in one account and also for the banks who have to maintain only one cash credit account for all transactions of the customer. The account can also be operated whether the balance is in debit or credit. It avoids repetitive documentation.

4.11 The banks as well as customers are accustomed to this system. The cash credit system, by and large, operates satisfactorily during normal times, but in times of stress and strains, it is somewhat open to misuse. The disadvantages attributed to the system, however, mainly relate to the manner in which it was operated before the Tandon Committee recommendations were implemented. After implementation of the above recommendations, particularly the norms for inventory and receivable holdings and the information system, many of the drawbacks attributed to it are no longer much relevant.

Loan System

4.12 The main advantage of the loan system for working capital purposes is that loans would be for pre-determined short durations. The borrower would have to negotiate every time with the bank for taking or renewing the loan and it is open to his bank to grant or refuse such request depending upon its own cash resources and the credit policy of the monetary authorities. As the loans are for definite purposes and periods, the borrower is required to plan his cash budget, as otherwise he may be saddled with surplus funds or may find it difficult to meet his requirements of funds in time. This, it is argued, would ensure a degree of self-discipline in his borrowings from the bank. To that extent the management of funds on the part of banks would become easy and the bank would be able to plan its credit portfolio rationally. This, in turn, would enable the monetary authorities to regulate credit effectively. Thus, at the most, under the loan system during a period of credit restraint there would not be any further reduction in advances if the borrowers do not repay the loans in time, but there is also no danger of a credit spurt, as further loans atleast can be curtailed by banks at their discretion.

4.13 The loan system has a built-in programme for review at short intervals unlike in the cash credit system, as the banks would be automatically reviewing the loan when it falls due for payment. There are other incidental advantages like book-keeping convenience, avoidance of leakage of income due to miscal-

culation of interest, etc. The system is also comparatively simple unlike the cash credit system with its cumbersome practice of giving limits and sub-limits within the overall limit.

4.14 The main disadvantage of the loan system is, however, its inflexibility and on account of this inflexibility it is stated that the advantages attributed to the system also become diluted in actual operation. Thus, as loan would have to be negotiated every time, there would be a tendency on the part of the borrower to borrow more for providing against contingencies instead of undergoing the time consuming process of negotiating fresh loans when such contingencies arise. In a way, this would be parallel to the borrower asking for more credit under the cash credit system. Under the cash credit system he does not have to pay for obtaining such excess limit; under the loan system he would have necessarily to pay the price. However, consideration of the higher cost may not necessarily deter a borrower from procuring larger quantum of loan than required when the price escalations and credit restraint are apprehended. The increased cost of funds (which in any case would be a small part of the cost of production) would, it is stated, be more than offset by having the funds when needed. In such a situation it may happen that the additional funds obtained would be kept in liquid form within or without the banking system. In the former case, the deposits base of the banks would increase with the concomitant creation of potential for further expansion of credit. If it is kept outside the banking system, it means an addition to the money supply in the parallel market. In effect, whereas under the cash credit system the unutilised limit or gap is a potential basis for further expansion of credit, the unused portion of funds raised by way of loans would pose a similar threat.

4.15 The purpose of the loan would have to be necessarily determined at the time of the grant of loan, but once the funds are disbursed under the loan system the banks have no further control over the use of funds and it would not be possible to ensure that the funds are utilised for the purpose for which they are borrowed. Verification of the ultimate use of funds becomes then equally difficult as in the cash credit system.

4.16 The concept that the cash credit is a 'roll-over' credit and although expected to be for short-term purposes, but is never repaid, would hold good for the loan system as well. The individual transaction loans have to be usually combined with revolving credit agreement and informal lines of credit which are virtually commitments to give loans, arranged in advance, as and when required by the borrower. The loans are also more often renewed than repaid. Thus, it is argued that the loan system also would in effect be a 'roll-over' credit. The loan system in India has certain operational difficulties as well. The loan documentation is more comprehensive than under cash credit and may give rise to some complications under the existing legal provisions relating to registration of charges, etc.

4.17 In U.S.A. and other countries where the loan system is developed, there are well-developed secondary markets to supplement bank finance. It may not be possible in Indian conditions to depend solely upon the loan system for financing industrial borrowers, as there are no such secondary markets. Single

transaction loans are, however, a popular form of finance in India also for specific purposes where the borrower does not have any continuous cash generation and the repayments are mostly in instalments fixed on the basis of the capacity of the borrower to repay. Its extensive use in the case of large industrial borrowers would not confer any particular advantage compared with the cash credit system for their day-to-day operations. It may, however, be used with advantage for specific purposes and for short durations in the case of large borrowers as well.

Bill system

4.18 The bill system of financing is under Indian conditions more or less an adjunct of the cash credit system. Several Committees/Study Groups have recommended progressive use of bill system in India and have highlighted the various advantages accruing to the borrowers, bankers and central banking authority. The use of bill of exchange as an instrument of credit would enable the banks and others with surplus funds to buy bills of various maturity and those who are in deficit to discount such bills in the market to suit their requirements. It thus helps eligible banks to approach Reserve Bank only if they fail to get the required amount from the market, thereby imparting flexibility in the money market by evening out the liquidity in the banking system and would also enable the monetary authority to exercise more effective control over the money market. As the date of repayment is definite under the bill system, the credit planning by banks becomes comparatively simplified. The bill, being a self-liquidating short-term asset, is an eminently suitable financial instrument for banks, as their resources are basically of short-term nature. It is also a secure form of advance. From the supplier's point of view also the bill system is preferable as he can expect payment of the bills at a pre-determined time and accordingly plan his production and cash budget.

4.19 The bill system too has certain limitations. It has been argued that bills can be drawn only for certain types of transactions and it cannot totally replace other systems of lending. As the drawees are committed to a definite period of payment, they would be reluctant to accept the bills drawn by the suppliers. The process of evolution is, therefore, likely to take time. The cost of operation for borrowers and the cost of administering the system by banks would also be somewhat high on account of stamp duty and detailed book-keeping. Still the advantages of the bill system of financing outweigh their disadvantages and there is a need for encouraging the bill system of financing. The increased use of the bill system can avoid some of the undesirable features in the lending system based mainly on cash credits.

No system is superior to others

4.20 Comparing the advantages and disadvantages of the different systems of lending, it is not possible to come to any conclusion that one system is superior to the other. More than the system, the manner in which it is operated is more relevant in deciding whether the system is amenable to rational management of funds and credit discipline. There is, therefore, prima facie no reason why one system should be preferred over the other, although under certain circumstances and for particular types of transactions one system may be more convenient than the other.

Existing lending system in the country

4.21 The existing system of lending in the country is a combination of cash credit, bills and loans. By and large, the loan system (short and medium-term) is used where the borrower needs the money in a lump sum for definite purposes such as purchase of durable goods like tractors and vehicles, equipments for professionals, consumer loans, meeting cost of agricultural operations, packing credit for export purposes, etc. Normally, these loans are repayable in instalments and as funds are required for single nonrepetitive transactions, no further withdrawals are necessary. The cash credit system is common for financing the working capital requirements of manufacturing and trading concerns. Small-scale, medium and large industries all avail of cash credit facilities as also the trading community, whether big or small. The rationale behind the use of the cash credit system of lending by these groups of industries and traders is that in their day-to-day operations they generate cash regularly. The cash credit account is, therefore, ideally suited for their purposes. The bill system is used to supplement cash credit system mainly for financing sales and receivables and to some extent, by drawee bills system, to finance purchases. It is used by both trade and industry, small-scale as well as medium and large. It will not be possible to replace the cash credit system completely by bill finance, although the extent of the use of the cash credit can be curtailed progressively by increased use of bill finance for purchases and sales.

Recommended lending system

4.22 In most of the other countries also, albeit with a difference in the extent of utilisation, the three systems of financing are prevalent. The Group considers that the advantages of the existing system of extending credit by a combination of the three types of lending, viz., cash credit, loan and bill should be retained. At the same time it is necessary to give some directional changes to ensure that wherever possible the use of cash credit would be supplanted by loans and bills. It would also be necessary to introduce necessary corrective measures to remove the impediments in the use of bill system of finance and also to remove the drawbacks observed in the cash credit system. In making these recommendations, the Group has been guided by the fact that they can be implemented not only without undue strain and addition to operational costs but also without causing hard-ships to borrowers.

Use of Loan System

4.23 The short-term loan system with facility for repayment in instalments where necessary should be increasingly used for financing small borrowers, particularly in the priority sectors, for grant of packing credits for export purposes and generally for all types of 'single transaction' finance. This system could also be used where necessary in the case of medium and large borrowers for grant of adhoc accommodation for specific needs, e.g., bunching of imports, bonus payments, advance payment of income-tax, unexpected delay in collection of receivables, etc. The advantages of the use of this system in such cases are that the credit disbursal is linked to a specific purpose and repayment is time-bound. This is necessary as the bank in such cases extends special accommodation to enable the borrower to tide over his temporary resources constraints which should normally be taken care of from his cash generations.

4.24 Bill limits are provided either to the seller to finance his receivables arising out of sale of finished goods (purchase/discount of drawer's bills) or to the purchaser, for acquisition of raw materials (acceptance/discount of drawee bills). While the bill system of financing receivables is quite popular in the country, the drawee bill system for financing purchases has not still made much headway. The drawee bill system also requires to be encouraged and should progressively replace cash credits against raw materials and inputs. This system would help payment to the suppliers on a definite date, besides ensuring the end-use of credit and relating it to the actual needs of the purchaser. The reasons for the slow growth of the drawee bill system are mainly two-fold:

Use of Bill system

(*i*) the absence of a secondary market for bills; and

(*ii*) reluctance of Government departments/public sector undertakings and other large and medium industries to subject themselves to discipline.

These impediments require to be removed and suggestions in this regard have been given in subsequent chapters.

4.25 Despite the increasing use of loans and bills in working capital finance the borrowers would still require the cash credit facilities mainly for holding inventories which cannot be financed through bills. The analysis of the various systems of lending made by the Group shows that total replacement of cash credit system in Indian conditions is not feasible. Various Committees, including the Tandon Committee, which examined this question in the past, have also not recommended the total substitution of the cash credit system by other systems. Efforts have, however, to be made to narrow the gap between the sanctioned limits and their utilisation to the extent possible and to strengthen the appraisal and follow up measures under the cash credit system. The suggestions in this regard have been examined in Chapter V.

Use of cash credit system

CHAPTER V

Proposed amendments to the lending system

Tandon Committee refinements in lending system

5.1 With a view to making the lending system more amenable to credit planning by banks and in order to prevent speculative build up of inventories, the Tandon Committee made some recommendations which were accepted by Reserve Bank of India and were communicated to banks for implementation as an integrated scheme of lending discipline. Although the inventory norms and the mode of fixation of the limits on the basis of peak level of requirements are being implemented by banks, by and large, the recommendation relating to style of credit, i.e., bifurcation of the cash credit limit into a 'core' loan portion and a 'variable' cash credit portion has not been put into practice to any significant extent. Similarly, the quarterly information system which is an integral part of the Tandon Committee's recommendations has not been implemented with the attention it deserved. In the absence of these statements, there is no mechanism to regulate the drawings from the cash credit account by the borrowers on the basis of genuine requirements. When a system is to be implemented in its totality, implementation of it in part is not likely to achieve the desired results.

Bifurcation of credit limit into core and variable portions

5.2 The Group has, therefore, examined in depth the circumstances which prevented banks from fully implementing these recommendations of the Tandon Committee, viz.,

(*i*) the bifurcation of the cash credit limit into loan component (for core portion) and demand cash credit (to meet the fluctuating requirements) and

(*ii*) introduction of the quarterly information system.

The rationale behind the suggested bifurcation is that the amount of borrowings by industrial units particularly in non-seasonal industries does not fall below a certain level which represents the stable fund requirements during the year. The demand loan component would comprise the minimum level of borrowing which the borrower is expected to use throughout the year, while the cash credit portion would take care of the fluctuating requirements. The bifurcation, the Tandon Committee felt, would induce the customer to plan his needs carefully and in order to encourage the borrowers to fall in line with this discipline, a provision was made for charging interest on the loan component at 1% per annum lower than that on the cash credit component. Despite the lapse of a period of over three years, the system of bifurcation has not found acceptance either on the part of the banks or the borrowers.

Reasons for non-segregation of core limit

5.3 One of the reasons given by the banks for not segregating the core portion is that there is no need for bifurcation of the core portion and its conversion into a separate loan account, because the banks are aware of the extent of the core portion on the basis of minimum drawings in the past years. Moreover, the core is not constant and is itself subject to variation over a period depending upon the level of production and the cost factor; banks also apprehend difficulties in documenta-

tion, registration of charges, etc. On the other hand, as interest on the loan portion is lower, banks stand to lose considerable income on such core portion and in the prevailing trend of declining profits, they could ill afford to accept such a change. Under the cash credit system, the borrowers pay interest only on the day-to-day balances. In case the variable cash credit portion is in credit, under the system of bifurcation, it is not open to them to adjust such surplus funds to the core portion. Therefore, they feel that they would have to pay a higher effective rate of interest. These issues were also discussed from time to time during the deliberations of the Committee of Direction (constituted by Reserve Bank of India to consider and advise on the problems that may arise in implementing the recommendations of Tandon Committee) and at one time, it was suggested that the interest differential between the demand loan and variable cash credit portion could be reduced from 1% to ¼%. No final decision has, however, been taken by the Reserve Bank in this regard.

Group's view on core segregation

5.4 The Group has considered the various aspects involved in the bifurcation of cash credit into a 'core' portion and a 'variable' cash credit portion. It feels that the bifurcation may not serve the purpose of better credit planning by narrowing the gap between sanctioned limits and the extent of utilisation thereof. Unless the core portion is fixed at a fairly high level, say about 80 to 85 per cent of the total cash credit (to which many of the borrowers may not agree), the disadvantage of the gap in the system would remain, even after bifurcation, in the variable cash credit portion. Further, the core idea is not applicable to seasonal industries like tea, sugar, coffee or tobacco where the cash credit accounts are usually in credit for a part of the year. In the light of these reasonings, the bifurcation of cash credit limit into a demand loan portion and a 'variable' cash credit portion is not likely to be voluntarily accepted and it does not confer enough advantages to make it compulsory.

'Core' as seen by Dehejia Committee

5.5 The idea of the segregation of the core portion as mooted by the Dehejia Committee was with a view to its gradual elimination. According to that Committee the hard core would represent the minimum level of raw material, finished goods and stores which the industry is required to hold for maintaining a given level of production. The fluctuating part of the account would constitute strictly short-term component representing the requirements of funds for temporary purposes, e.g., short-term finance, tax, dividend and bonus payment, such borrowings being adjusted in short period out of sales. The Dehejia Committee observed that the duration of the loan on a term basis representing the hard core of the cash credit would depend upon the capacity of the unit to generate cash accrual for reducing the outstandings and recommended that such loans should be subject to repayment programme on the same lines as for term loan granted by the banks and term lending institutions for acquiring fixed assets. The Tandon Committee, after examining this issue, observed: "During our discussions with representatives of term financial institutions also, we were told that they could not undertake the responsibility of providing funds for the 'hard core', for they felt that this would only mean further financing of old units, instead of financing the promotion of new industrial activity". It, therefore, recommended that instead of making the entire credit limit as cash credit for the year, it should be bifurcated as loan and demand cash credit, which would be reviewed annually.

5.6 The question whether the hard core portion as propounded by the Dehejia Committee could be segregated and made repayable over a period of time, depending upon actual cash generation was considered by the Group. There are several operational difficulties in segregating the hard core portion from the cash credit limit which should be eventually repaid by the borrower out of the cash generated. In seasonal industries, for instance, there is no such hard core portion at all. Normally, the accounts come into credit in off-season except under extra-ordinary circumstances. The question of having a core portion which should be eventually repaid, therefore, does not arise in such units. In other cases, where the fluctuations in an account are minimal, the hard core portion would be virtually the same as the limit sanctioned. If, therefore, this portion of the limit is to be repaid over a period of time, it would mean that such units would not be entitled to any bank finance except for temporary purposes. This is again a position which the Group finds it difficult to accept. The segregation of the core portion as envisaged either by the Tandon Committee or by the Dehejia Committee cannot, therefore, be a practicable solution.

Segregation of core as conceived by Dehejia Committee

5.7 At the same time, the Group has felt the need for reducing the over-dependence of the medium and large borrowers—both in the public and private sectors—on bank finance for their production/trading purposes. There has been hitherto a belief among the banking and industrial circles that it is the responsibility of the commercial banks to provide at all times the entire working capital requirements of the industrial sector. Consistent with this belief, it has been hitherto taken for granted that the surplus cash generation of a unit should be available for its expansion, although there are term lending institutions to provide for such capital expansion programmes. Whatever might be the justification for such a belief in the past, there is need for a serious rethinking on the subject in the present context. As indicated in para 2.3, out of the additional deposits of every Rs. 100 that accrue to the banking system, roughly only about one-fourth of the additional deposits would be available at present to the medium and large scale industrial sector as well as trade. Thus, with the limited availability of resources for these sectors, the weaker and the new units in these sectors are likely to be neglected, as the banks would be more concerned with the needs of their existing units, particularly the stronger ones. An equitable distribution of the scarce resources under the present day circumstances would be possible only if the available scarce funds are utilised for genuine short-term requirements of this sector. So, the net surplus cash generation of an established industrial unit should be utilised partly atleast for reducing borrowing for working capital purposes. This principle should also apply to the trading sector. In other words, the established units should not divert their cash generation exclusively for expansion purposes which should legitimately be financed by promoter's own funds by way of deposits or issue of share capital or debentures and institutional agencies. A question that can arise in this context is whether the insistence on the use of cash generations for reducing working capital borrowings, thus precluding their use for capital expansion purposes, would not curb industrial growth. Inasmuch as this reduces the reliance on bank resources by some of the borrowers and releases funds which could be lent to others for productive purposes, this argument would not hold good. It would on the other hand check the potential of the stronger

Reducing over-dependence on bank borrowings

and larger houses to expand. This object is consistent with the Government's policy of curbing the growth of monopoly houses and dispersing bank credit among a wider section of borrowers.

Enhancement of owner's contribution

5.8 The owner's contribution for working capital purposes can be enhanced without structurally changing the Tandon Committee style of lending. According to the Tandon Committee recommendations, at present the limits are fixed on the following basis:

(*a*) The current assets, i.e., inventory holding and receivables on the basis of the prescribed norms for a given level of production as well as other current assets are estimated in the first instance.
(*b*) The current liabilities other than bank borrowings also are similarly estimated.
(*c*) The difference between (a) and (b) is taken as the working capital gap.

This gap is to be provided partly by surplus long term resources (owned funds and term finance less fixed and non-current assets) and partly by bank borrowings. The amount provided by the surplus in the long term resources is treated as the owner's contribution. Under the First Method of lending, this contribution is fixed at 25% of the working capital gap. In order to reduce the reliance of the borrowers on bank borrowings by bringing in more internal cash generation for the purpose, it would be necessary to raise the share of the contribution from 25% of the working capital gap to a higher level.

Borrowers to be placed under Second Method of lending and excess borrowings to be converted into Working Capital Term Loan

5.9 The First Method of lending gives a current ratio of only 1:1. This is obviously on the low side. Although it was the intention of the Tandon Committee that the borrowers should gradually progress from method I to method II, by and large, it has not happened in practice. A shift to method II will necessarily imply increasing either the capital funds or the term borrowings. Because of the tax advantages in bank borrowings, borrowers are normally reluctant to improve their gearing ratio. Similarly, on account of convertibility clause, borrowers are also reluctant to make increasing use of term borrowings. Because of the above considerations, it is hardly likely that left to themselves the borrowers would voluntarily move to method II.

In order to ensure that the borrowers do enhance their contributions to working capital and to improve their current ratio, it is necessary to place them under the Second Method of lending which would give a minimum current ratio of 1.33:1. As many of the borrowers may not be immediately in a position to work under the Second Method of lending, the excess borrowings should be segregated and treated as a working capital term loan which should be made repayable in instalments. To induce the borrowers to repay this loan, it should be charged a higher rate of interest. For the present, the Group recommends that the additional interest may be fixed at 2 per cent over the rate applicable on the relative cash credit limits. This procedure should be made compulsory for all borrowers having aggregate working capital limits of Rs 10 lakhs and over. Units which have been identified as sick and are under a nursing programme or where rehabi-

litation measures are under active consideration of the banks may, however, be exempted from this discipline.

The method suggested above is worked out in the illustration given below:

Current liabilities		Current assets	
Creditors for purchases	100	Raw material	200
Other current liabilities	50	Stock in process	20
		Finished goods	90
Bank borrowings including bills discounted with banks	200	Receivables including bills discounted with banks	50
		Other current assets	10
	350		370

In the above illustration, the difference between current assets and current liabilities (i.e. 20) would represent the actual contribution from the long-term sources.

Under the Second Method of Lending

Current assets		370
25% of the above from long-term funds (borrower's owned funds and long term borrowings)		92
Balance		278
Less : Current liabilities other than bank borrowings		150
Balance representing maximum permissible bank borrowings		128
Working capital gap comprising :		220
Bank borrowings	128	
Long term funds ..	92	

As the long term funds available in this case is only 20 as against the prescribed amount under the Second Method of lending at 92, the excess borrowings would be 72. What is proposed by the Group is that the excess borrowings of 72 (or in other words the shortfall in the contribution of the minimum required at 92 and the actual contribution available at 20, i.e., 72) should be converted into a working capital term loan which should carry a higher rate of interest and placed on repayment basis.

Banks should evolve a suitable procedure for ensuring regular repayment of the working capital term loan. One way this could be done would be to appropriate a small percentage out of the proceeds of sales bills, discounted or collected, towards adjustment of these dues.

5.10 It has been pointed out in paragraph 3.10 that one of the reasons for the gap is the system of fixing the credit limits on the basis of peak level credit requirements. The peak level requirements of the borrower would be normally for short periods. There is no reason why a borrower should be given a limit throughout the year at the peak level while his normal requirements for the major part of the year would be at a lower level. The Group, therefore, recommends that there should be separate limits for 'normal non-peak level' requirements and 'peak level' requirements. The borrowers would indicate both the normal non-peak level and the peak level requirements in their applications for credit. While assessing the credit requirements, the bank should appraise and fix separate limits for the normal non-peak level as also for the peak level credit requirements indicating also the periods during which the separate limits would be utilised by the borrower.

Peak level and normal non-peak level limits to be separate

5.11 Peak level requirements are at present being shown separately, where necessary, in the application forms to be submitted by banks under the Credit Authorisation Scheme. What is being attempted now is to widen the application of this procedure and extend it to all borrowers currently under the revised lending discipline prescribed by the Tandon Committee, i.e., borrowers having limits of Rs 10 lakhs and above. The concept of peak level and non-peak level requirements is fairly obvious in the case of seasonal industries like tea, coffee, sugar, tobacco, etc., where the accounts in normal circumstances would be in credit for a part of the year. The concept also applies to certain other industries where either the input or output is seasonal, although the relative accounts may not necessarily come in credit for a part of the year. For instance, in industries manufacturing vegetable oil/ghee, rice and flour milling, jute, cotton textiles, etc., the input being agricultural commodities is seasonal. The supply is to some extent evened out through the medium of procuring agencies; still at particular points of time during the season, the raw material inventory may be higher than at other times. Similarly, in industries producing consumer goods like fan, refrigerators, woollens, etc., because of the seasonality of demand, at particular points of time the finished goods and receivables may be high. Even in industries where there is no such seasonality in input or output, determinable factors like purchases of raw materials in lot, payment of tax, bonus to staff, dividend, etc., may create a demand for funds at particular points of time. A scrutiny of the operations in the account in the past would reveal such seasonal tendencies. Wherever there are pronounced seasonal fluctuations in the accounts, banks should insist upon the borrowers giving their peak level and normal non-peak level requirements in their applications for fixing separate credit limits for such periods. If there is no such pronounced trend, peak level and seasonal requirements should be treated as identical and limits fixed on that basis.

5.12 One of the important criteria for deciding the normal non-peak and peak level requirements should be the borrower's utilisation of credit limits during such periods in the past. Many banks have expressed the view that the borrowers consider the inventory norms prescribed by the Tandon Committee as the minimum level on the basis of which they are entitled to obtain credit, although the Tandon Committee has made it clear that the norm is not an entitlement to hold inventories or receivables upto that level. The Tandon Committee

Past utilisation to be an important criterion for fixing limit

has further stated that if the inventory levels in the past were lower than the level prescribed by them, such lower level should prevail. In the light of this observation, where the limits asked for by a borrower are much in excess of what he has been utilising in the past during the respective periods, other factors remaining unchanged, the limits should be suitably aligned.

Financing temporary requirements through loan

5.13 The requirements of funds upto the sanctioned limits should be financed through a regular cash credit account. If any ad hoc or temporary accommodation is required in excess of the sanctioned limits to meet unforeseen contingencies, the bank should carefully consider the request and if it is satisfied and also after obtaining authorisation under the Credit Authorisation Scheme, where necessary, the additional finance should be given through a separate demand loan account or a separate 'non-operable' cash credit account.*

The demand loan or 'non-operable' cash credit portion should be availed of by the borrower only after fully utilising the regular cash credit account upto the sanctioned limits and is intended only for meeting contingencies and unforeseen circumstances. Such temporary accommodation should be extended only for pre-determined short durations and should be liquidated within the stipulated period. The discipline outlined in this paragraph may be made applicable only in cases involving working capital limits of Rs 10 lakhs and above. Food and export credit would be exempted for this purpose.

Penal interest on temporary borrowings

5.14 As any additional accommodation would put the bank's credit planning out of gear, there should be a stiff penalty for the demand loan or 'non-operable' cash credit portion, at least two per cent over the normal rate unless the Reserve Bank in consideration of the general adverse conditions in a particular industry or a particular unit exempts such penalty. This is necessary to discourage borrowers from asking for such extra limits without adequate reasons. Moreover, though the bank would be charging a penalty, for the borrower it is only the cost of management of the 'imponderables and uncertainties' which is essentially a function of the entrepreneur and not that of the banker.

Penalising over-use and under-use of indicated levels of borrowings

5.15 Having fixed the limit on the basis of normal non-peak level as well as peak level requirements, a borrower should be asked to give his quarterly requirement of funds before the commencement of the quarter on the basis of his budget, the actual requirement being within the sanctioned limit for the particular peak level/non-peak level periods. Such indication would be the operative limit for the quarter. Drawings less than or in excess of the operative limit so fixed (with a tolerance of 10% either way) but not exceeding sanctioned limit

* It may be mentioned that the difference between the demand loan and 'non-operable' cash credit is not significant; in both cases there would be only a single debit for the whole amount of excess required and the repayment can be from time to time according to the cash generation. It is not open to the borrower to recycle the funds in this account and once repaid in part or full, limit stands reduced or cancelled as the case may be. Although the demand loan and 'non-operable' cash credit are effectively the same, both the alternatives are being given only to suit the convenience of banks particularly from documentation angle.

would also be subject to a penalty to be fixed by the Reserve Bank from time to time. For the time being the penalty may be fixed at 2% p.a. Drawings in excess of the operative limit should, however, be subjected to a close scrutiny by the banks and allowed only where they are satisfied that such excess is warranted. To avoid misuse of such a provision as observed in the past, the borrower would be required to submit his budgeted requirements in triplicate and a copy each would be sent immediately by the branch to the controlling office and Head Office for record. If a borrower fails to submit his quarterly projections before the end of the preceding quarter, sanctioned limit (peak or non-peak as applicable) should be deemed to be the 'drawdown' limit indicated by him for the quarter and the account operated and penalties levied on the basis of such limit.

Penalisation provisions introduced by the Reserve Bank in 1970

5.16 The idea of penalising the borrowers for not estimating their credit requirements properly is not new. The Reserve Bank of India had advised banks in March 1970 to levy a commitment charge at the rate of 1% p.a. in respect of the unutilised portion of the credit limit from April 1, 1970. In the calculation of the unutilised limit, the borrower's own indication of his credit requirements in any quarter was to serve as the basis. Commitment charge was to be levied on the unutilised portion of the credit limit, i.e., the difference between the amount indicated by borrower as the maximum extent during any quarter to which he would utilise the limit and the average over said quarter of the credit limit actually used by him. In cases where the indicated quarterly limits were exceeded, banks were given the option in May 1970 to take such action as they deemed necessary in the matter of accommodating parties drawing in excess of such limits and in levying appropriate charges on such excess drawings. Subsequently it was represented to the Reserve Bank that the insistence on the quarterly indication of credit requirements caused some hardship to certain categories of borrowers who experienced difficulties in estimating their credit needs for a quarter as such. It was, therefore, decided in March 1971 that such borrowers might be permitted to indicate to the banks their maximum credit requirements on a monthly basis instead of on a quarterly basis. It was also decided that no commitment charge should be levied by a bank if the average monthly/quarterly utilisation did not fall short of 95% of the maximum monthly/quarterly requirements indicated by borrowers. Similarly, no charge was also to be levied in cases where the drawings by parties exceeded the indicated limits by not more than 5% for a period not exceeding one week. The following categories of credits were exempt from commitment charges:

(*a*) credit limits of less than Rs 10 lakhs in each account;

(*b*) credit limits granted to the Food Corporation of India, State Governments and their authorised agencies for the purpose of food procurement storage/distribution operations;

(*c*) credit limits sanctioned in respect of bills purchased and discounted (inland and export bills);

(*d*) advances against such bills taken for collection, letters of credit and packing credit for exports;

(*e*) credit limits granted to State Trading Corporation for the purpose of storage/distribution of soyabean oil and sunflower oil;

(*f*) credit limits sanctioned in respect of all types of export finance including advances against duty drawback and cash incentives, etc., in respect of exports due from Government or other appropriate authorities;

(*g*) credit limits sanctioned for import of goods under letters of credit or otherwise, in respect of import bills and trust receipt facilities for release of import documents, clearance and disposal of covered merchandise within the specified period; and

(*h*) credit limits upto Rs. 25 lakhs granted by scheduled commercial banks to other banking institutions and co-operative banks having demand and time liabilities not exceeding Rs. 25 crores. (These exemptions were also extended to land development banks and State Financial Corporations including Tamil Nadu Industrial Investment Corporation Ltd., with some modifications).

The above system of commitment charges was withdrawn in November 1975 after the Tandon Committee recommendations were accepted.

The system, the Group is proposing, is also on similar lines with the stipulation that over-utilisation of the indicated limits would also be compulsorily subjected to penalty. The extent of tolerance would be raised from 5% to 10%. The penalty would be applicable only in respect of parties enjoying credit limits of Rs 10 lakhs and above. 'Food' Credit and 'Export' Credit would be exempted from the penalty. As this measure is linked with and is a part of the lending discipline, the Group feels that the quarterly information system need not normally be substituted by monthly indications of credit requirements as was permitted in the earlier scheme of commitment charges.

Proposed system of commitment charge and penalty for excess drawings

5.17 In the calculation of the unutilised limit/excess drawings the borrower's own indication of his credit requirements in any quarter would serve as the basis. Thus, though the limits sanctioned may be related to the peak level or normal non-peak level requirements, the borrower would be expected to indicate to the bank his actual requirements of credit (within the sanctioned limit) in any quarter (for the sake of convenience, this may be termed as the 'indicated limit'). The degree of utilisation, both for commitment levy and penalty, would be calculated with respect to such 'indicated limit'.

5.18 The system of levying commitment charge on unutilised portion of the credit as well as penalty on excess drawings may be imposed by means of a directive under section 21 of the Banking Regulation Act. The commitment charge may be calculated on the basis of the unutilised portion of the credit limit which shall be the difference between the indicated limit and the average over the said quarter actually utilised by him, subject to such conditions, as may be prescribed by the Reserve Bank of India. The penalty may be calculated on the excess drawings in the credit limit which shall be the difference between the amount

actually utilised by the borrower and the indicated limit subject to such conditions, as may be prescribed by the Reserve Bank of India.

5.19 The following points may be borne in mind while levying commitment charge/penalty:

(*a*) Credit limits of less than Rs 10 lakhs may not be subjected to commitment charge/penalty.

(*b*) Commitment charge/penalty may be made applicable to the existing limits also. If the bank anticipates any difficulty in levying these charges in terms of any existing contract, it may, if necessary, recall the advance (being on a demand basis) and renegotiate the limit to provide for levy of such charges.

(*c*) In cases where the quarterly average utilisation of the limit falls below the indicated limit (subject to what is stated in (d) below) banks should charge commitment levy on such shortfall. If in any case, the daily utilisation of the limit exceeds the indicated limit (again subject to what is stated in (d) below) banks should charge penalty on such excess.

(*d*) In order to provide for some flexibility in the operation of the scheme, banks should levy commitment charge only if the utilisation falls short of 90% of the indicated limit. For the purpose of calculating the average, the drawings in excess of the indicated limit may have to be excluded. Penalty should be levied on a daily basis only if on any day the utilisation goes beyond 110% of the indicated limit.

(*e*) The commitment charge/penalty should be levied on cash credit account, overdraft, bills purchased, bills discounted and any other form of accommodation (except advances given by way of loans) which involves outlay of funds irrespective of the terminology used by the banks in describing such accommodation, subject to the exemptions proposed.

(*f*) The borrower should be instructed to submit the statement showing the indicated limit in triplicate within seven days before the commencement of the quarter. The branch office concerned should immediately send a copy to his controlling office and another copy to the Head Office for record. It would not be permissible for the bank to allow any changes in the indicated limit except with the approval of the Reserve Bank of India.

(*g*) The amount levied by way of commitment charge/penalty should be reported to Reserve Bank of India periodically.

(*h*) In case a borrower fails to submit the indicated limit in time the sanctioned limit for the concerned peak/non-peak period as the case may be, should be deemed to be the indicated limit for the quarter and commitment levy/penalty charged on the basis of such limit.

5.20 The following limits would be exempt from the commitment levy/ penalty charges.

Exemptions

(*a*) Credit limits granted to the Food Corporation of India, State Governments and their authorised agencies for the purpose of food procurement, storage and distribution operations.

(*b*) Credit limits sanctioned by way of negotiation of bills in respect of exports as well as other advances for export purposes including advances against duty drawbacks, cash incentives, etc., in respect of exports due from Government or other authorities.

(*c*) Credit limits granted to commercial banks, financial corporations and co-operative banks including land development banks.

Information system—Simplification of forms and penalisation for delayed submission

5.21 The success of the proposed lending scheme depends on the timely submission of the quarterly statements under the information system so that the quarterly operative limit can be fixed before the commencement of the quarter. As stated in paragraph 5.2, the information system recommended by the Tandon Committee has yet to take firm roots. It has been represented to the Group, in this context, that the non-submission of the returns in time is partly due to certain features of the forms themselves. The main difficulty in this regard is stated to be the requirement of getting the actual figures of the preceding quarter and profit projections which borrowers find it difficult to furnish in time. To get over this difficulty the forms have to be suitably simplified. Revised forms for this pupose are given in Appendix V.

Under the revised forms the borrowers would be required to furnish the quarterly projected levels of current assets and current liabilities (including bank borrowings) without the data regarding profitability projections and cash flow, before the commencement of the quarter. The actual figures relating to performance for the previous quarter would be submitted later, within six weeks after the close of the quarter. The profitability data and the cash flow would be furnished only once in a half year within two months from the close of each half year. With the splitting up of the quarterly statement as recommended above the Group is of the view that there would not be any difficulty for borrowers to submit the statements in time. As the quarterly information system is part and parcel of the revised style of lending under the cash credit system, it is absolutely necessary that the borrowers submit the revised returns in time. To ensure this, the Group recommends that if the borrower does not submit the return within the prescribed time, he should be penalised by charging the whole outstandings in the account at a penal rate of interest, 1 per cent per annum more than the contracted rate for the advance from the due date of submission of the return till the date of its actual submission.

Relaxations from norms

5.22 Along with the change in the mode of fixing limits, the Group also considers it necessary that request for relaxation from inventory norms and for *ad hoc* increases in limits should be subjected to close scrutiny as otherwise the purpose of fixing limits on the basis of normal non-peak level/peak level requirements as recommended in paragraph 5.10 above could be defeated. It is also necessary for banks to watch the

position of borrowers to whom relaxations from norms have been allowed in exceptional circumstances or in whose cases there is marked imbalance in the financial position and take steps to correct the position in the shortest possible time.

Toning up—Assessment technique

5.23 The scrutiny of the data at the operational level also requires toning up. To this end, it is suggested that banks may devise their own check lists in the light of the instructions already issued by the Reserve Bank for use by the operating units.

Delays in sanction

5.24 One of the main reasons adduced by the borrowers for inflating their requirements for funds is the delay in the sanction of limits at the level of banks as well as at the level of the Reserve Bank not only at the time of annual review and fixation of limits for the next year but also at the time of considering requests for temporary accommodation. As regards the delays of the first type, the limits being fixed on the basis of projections for the next year and as in the CAS forms, the data to be given for the current year are only estimates, there should be no difficulty for the borrower to submit his application well in advance of the expiry of his limits so that the fresh limits would be available before the expiry of the period of previous limits. If the application is made with the requisite data correctly compiled, there is no reason why there should be delay in sanctioning the proposal by the bank or in obtaining the authorisation for such proposal, where necessary, from the Reserve Bank. Close co-operation between banks and the borrowers would go a long way in reducing the delays to a large extent. A more important cause for concern on the part of borrowers is, however, delays of the second type. When a borrower requires temporary additional finance for meeting unforeseen contingencies, his need is obviously urgent and he has no confidence that the bank would meet such demands, in time. Such limits could normally be sanctioned by the officials at the operational level by exercising their discretionary powers. But if the limits applied for are beyond the discretionary powers vested in these officials, decision on such proposals should be taken by the appropriate authorities with expedition. The Credit Authorisation Scheme of the Reserve Bank of India provides for discretionary grant of temporary limits by banks upto specified amounts to take care of such situations. The Group, however, does not consider it advisable to recommend any sizeable increase in the discretionary powers vested in the operational level functionaries for taking care of temporary requests of large borrowers whose operations require a close watch at the Head Office level.

Bill system—Attempts so far made

5.25 The need for encouraging bill system of financing has been explained in paragraph 4.24. One of the reasons given for the slow growth of the system is the absence of a secondary market for bills. The Group's suggestions for establishment of a suitable institution for the purpose are given in Chapter VI. Another impediment to the widespread use of bill system of financing has been the stamp duty on usance bills. Various Committees have recommended in the past for reduction or abolition of such stamp duty. It has also been represented to the Group that stamps of the required denominations are not available freely as and when required. These questions may have to be taken up with

the State Governments. The question of reluctance on the part of Government Departments/public sector undertakings and other medium and large industries to subject themselves to discipline was, *inter alia*, considered by the Study Group on "Enlarging the use of Bills of Exchange as an instrument of credit and creation of Bill Market" in 1970. The recommendations made by the Study Group on this question, *inter alia*, were :

(*i*) The Reserve Bank may take up the question of changing the procedure of drawing supply bills on Government in such a way that they become an additional source of supply bills in the Bill Market. This would also mitigate the grievance of the contractors that Government takes unduly long time in settling their bills.

(*ii*) To overcome reluctance on the part of buyers of goods to subject themselves to the discipline of bills, the banks or the Indian Banks' Association should, in the first instance, educate the borrowers and try to persuade them to avail themselves of finance, necessary for sale of goods on credit, by way of discount of bills of exchange. In case persuasion did not yield results, the Indian Banks' Association might discuss the issue with its members who might come to an agreement that they would charge a higher rate of interest or stipulate stiff margins to discourage borrowings against book debts. Should these efforts fail to yield the desired result, the Reserve Bank of India might consider issuing appropriate advice or directive to the scheduled commercial banks, in order to discourage them from lending against book debts.

These recommendations were pursued by the Reserve Bank and banks were asked to ensure that not only the bills drawn by the larger concerns on the smaller ones but also those drawn by the smaller units on the larger ones were financed through bills. The Reserve Bank also took up with the Director General of Supplies and Disposals, Government of India and also with major public sector undertakings, the question of devising a procedure whereby bills in the regular form could be drawn on and accepted by the Government/public sector undertakings. Later, in 1972 a Committee was appointed (Ramanujam Committee) to go into the question of delayed payment of bills of small scale industries on Government Departments and large industries. This Committee also made several recommendations which included the conversion of credit sales by the suppliers into bills and fixing separate sub-limits within the overall credit limits sanctioned to medium and large industries for acceptance/letter of credit facilities covering their purchases from small scale industries.

The enlargement of the bill system of financing, which has been considered desirable from different angles by several Committees and Study Groups has been engaging the attention of both Government and the Reserve Bank of India for some time now. Recently, in August 1978 the Reserve Bank advised banks that the medium/large industrial borrowers should be asked to indicate in the statements submitted by them under the quarterly information system, the amounts due to small scale industrial units separately. This measure was intended to enable banks to examine the data furnished by the large/medium industrial borrowers and, if banks found from such data that there was delay in payment of dues to

small scale industrial units, the matter could be discussed appropriately with them. The discussions the Working Group had with bankers and industry interests at various centres have revealed that the problem of payment of bills of the industries by Government/public sector undertakings still remains ; so also the problem of the dues of small scale industrial units from medium/large industries both in the private and public sectors as well Government Departments. The role of the Government Departments and public sector undertakings, both as purchaser and seller of goods is indeed substantial. Some of the large industrial units have stated during the discussions that the amount due from Government and public sector undertakings even exceeded their substantial bank borrowings and in such circumstances they could not be expected to meet the dues of their creditors, including the small scale industries, in time.

Sales bills

5.26 By and large, the system of bill finance—purchase and discount of bills—is quite popular in the country for financing receivables. The Reserve Bank has also advised banks to replace cash credit against book debts by bill finance. The practice of financing book debts by cash credit is, however, still prevalent to some extent. The banks should review all such accounts and insist on the conversion of cash credit limits into bill limits.

Drawee Bill limit to be made a compulsory segment of cash credit

5.27 Although the use of sales bills is somewhat satisfactory, the system of drawee bills has not yet caught up, despite the diverse measures initiated by the Reserve Bank to popularise the bill system in general. The Group is, therefore, of the view that a stage has come to enforce the use of drawee bills in the lending system by compulsion. It, therefore, recommends that a beginning should be made by making it compulsory for banks to extend at least 50 per cent of the cash credit limit against raw materials to manufacturing units whether in the public or private sector by way of drawee bills. The Group recognises that in such cases, apart from the banker and the borrower, a third party is also involved. All the same, a definite beginning has to be made to move towards the bill system of financing purchase of raw material inventory. The objectives behind this recommendation by the Group are three fold, *viz.*, (*a*) to bring in financial discipline on the buyer in the purchase of raw material inventory and to ensure that the supplier in turn would be able to make better use of bank borrowings, (*b*) to create a suitable short-term financial instrument which may help in evening out the liquidity in the banking system and provide the Reserve Bank in the process with an effective tool for controlling credit and (*c*) to reduce the dependence on the cash credit system of lending to some extent and thus obviate partially some of the drawbacks in the lending system attributed to cash credit.

5.28 The Group is also advised by bankers that though the several steps taken in the past have not yet yielded the desired results in popularising the bill system of financing, with the incentives given by way of rediscounting such bills under the New Bill Market Scheme, some of the banks were able to build up a substantial bills portfolio. As the Group has recommended separately the creation of a discount house, *inter alia*, for offering bills rediscounting facilities to banks, it is convinced that the system could be worked, and worked well, under a certain

degree of compulsion. In order to popularise the drawee bill system, it is necessary to give proper guidelines to banks in the working of the system. In Appendix VI, the Group has, therefore, indicated the procedure which may be followed by banks in extending inventory limits by way of bills.

Drawee Bills System applicable to only large borrowers having working capital limits of Rs. 50 lakhs and over

5.29 To start with, it is suggested that the discipline recommended in paragraph 5.27 for compulsory use of drawee bills for financing 50% of the limit against raw material inventory should be confined to borrowers having aggregate working capital limits of Rs. 50 lakhs and above from the banking system. In order to give a fillip to this system the banks should encourage their larger borrowers to use 'usance bills' as far as possible to cover their purchases.

Segregation of dues of small scale industries included in Sundry Creditors

5.30 It is possible that for operational convenience bills of larger amounts only could be conveniently brought under the purview of the recommended scheme. At the same time it is necessary to ensure that the bills of small scale industries, whose bills are, by and large, likely to be of small amounts should not be placed at a disadvantage. At present no reliable data are available regarding the proportion of the dues of the small scale industries in the 'sundry cretors' amount of the medium/large industries in the private and public sector. At one of the discussions the Group had with the industry interests, it was indicated by some of the public sector units that they could maintain control accounts in their books for sundry creditors in respect of small scale industries and others separately. This would give precise data regarding the dues to the small units by large/medium industries. The Group recommends that banks should insist on the public sector undertakings/ large borrowers to maintain such control accounts and furnish such data in their quarterly information system. This would enable them to take suitable measures for ensuring payment of the dues to small units by a definite period by stipulating, if necessary, that a portion of limits for bills acceptance (drawee bills) should be utilised only for drawee bills of small scale industries.

A bird's eye view of the amended lending system

5.31 For a proper appreciation of the recommendations made in the earlier paragraphs it is perhaps necessary to give an overall picture of the lending system that will emerge on the implementation of these recommendations.

Its basic characteristics are :

(*a*) No structural changes in the existing system are proposed. The lending would continue through a combination of the cash credit/overdraft, loan and bill systems with certain directional changes to bring down the preponderant share of cash credit in the total lending.

(*b*) The contribution from long term sources (owned funds and term borrowings) to meet the total working capital requirements of a unit would be increased and the overdependence of larger units on bank borrowing, which is a comparatively cheaper form of resources than owner's funds on tax considerations, would be curbed. As a result, the concept that banks should not assume full responsibility for the total working capital requirements of the larger borrowers and that they should bring in their own resources

for the purpose increasingly would also be established. In order to enforce this, all the borrowers with limits of Rs. 10 lakhs and above would be placed under the Second Method of Lending proposed by the Tandon Committee and the excess borrowings would be converted into a working capital term loan with a higher rate of interest and made repayable over a specified span of time.

(*c*) The imponderables in the economy would necessitate temporary unforeseen demand for funds. As apart from banks, there are no alternative sources for raising funds in India, such additional finance to the extent needed would be provided by banks in separate 'loan' or 'non-operable cash credit' accounts at a higher cost and with a definite time-bound programme of repayment.

(*d*) When the borrowings show pronounced regular fluctuations, separate limits would be fixed for predetermined periods for peak level and normal non-peak level requirements so that the larger peak level limit would not be available for use during the normal periods and to that extent the gap of unutilised limit at any particular point of time would be reduced.

(*e*) The borrower would indicate through the quarterly statements under the information system his projected requirements during the quarter. Subject to some degree of tolerance, overuse and underuse of such projected indications of bank borrowings would be penalised.

(*f*) As cash credit limits are fixed on an annual basis and reviewed only at comparatively long intervals of one year or more, the quarterly information system would be made an integral part of the cash credit system, as then only the cash credit system would work smoothly. In order to ensure prompt submission of the quarterly returns under the information system, the forms would be simplified and non-submission of returns would be penalised.

(*g*) Part of the cash credit limit against raw materials would be compulsorily given only by way of Drawee Bills. This would automatically ensure better inventory control of raw material purchases and better discipline and planning consciousness among borrowers. To encourage further the bill system of financing (coupled with certain other objectives) a bill market would be developed in the country and for this purpose a separate institution should be set up.

5.32 The total effect of the proposed lending system would be thus—

Effect of the amended lending system

(*a*) to encourage short term loans for specific types of requirements,

(*b*) to encourage bill finance generally, and

(*c*) to curb the use of cash credit to some extent.

The cash credit system would be refined and the gap of unutilised limit would be reduced (but not eliminated—under the cash credit system some gap will always remain). Coupled with the information system, the cash credit would operate more or less like loans with the built-in review at short intervals.

CHAPTER VI

Discount House

Introductory—Different views on creation of a discount house in India

6.1 A reference was made in Chapter V to the need for creation of a bill market in the country. The opinion on this issue of the banks and the academicians whom the Group consulted is not uniform. The observations of the Banking Commission which had also looked into this question are as follows :

> "The question is whether the proposed merchant banking institutions should perform the functions of acceptance and discount houses. Two factors which are of basic relevance in this connection are the reputation and financial standing of the acceptor and the existence of a system for collecting credit information on borrowers. Under the present circumstances, it should be possible for commercial banks to undertake acceptance and discounting business because with their widespread network of branches they satisfy both the above conditions. In due course, however, after the bill market is sufficiently developed and the proposed merchant banking institutions acquire the necessary expertise, they may also enter the acceptance and discounting business. At present, therefore, there does not seem to be any need for specialised acceptance and discount houses though such institutions may be formed as joint stock companies in course of time to offer these facilities as well as for functioning as a money market intermediary to even out the demand for and supply of short-term finance in the market. As suggested in the chapter on Indigenous Bankers, the indigenous bankers could in due course also transform themselves into discount and acceptance houses. These institutions as and when they come to be set up should work under conditions prescribed by the Reserve Bank".

The Commission further observed :

> "As the economy grows, sophisticated financial institutions would be required to meet the growing credit needs of the community and discount and acceptance houses might become necessary. With their banking acumen and traditional skills the more efficient of the indigenous bankers could transform themselves into discount and acceptance houses provided that they adopt the corporate form of organisation."

Need for a discount house—various reasons

6.2 The Group considered the question from various angles and it has come to the conclusion that discount houses on the U. K. pattern for the purpose of giving purely rediscounting facilities for bills to commercial banks may not be a desideratum in India. A discount house which, however, can function as an independent body, subject to Reserve Bank's supervision, *inter alia*, to even out the liquidity imbalances in the banking system would be a welcome idea. Certain recent developments in the Indian money market regarding call money operations and participation certificates have reinforced this idea.

At present in India, but for acceptance of public deposits (which are also subject to cerain legal restraints), the banks remain the only legitimate source of working capital finance. The liquidity position may vary from bank to bank and from centre to centre. Certain institutions like Unit Trust of India, General Insurance Corporation, Life Insurance Corporation also have temporary surplus funds for short-term investments. Some machinery is necessary for evening out the liquidity amongst banks and other financial institutions as well as between different centres. Mechanism to operate this function till recently was the call money market with its system of brokers and the use of participation certificates. The defects observed in the broker system in the call money market and the abuses attached to the system have ultimately resulted in the Reserve Bank eliminating brokers from the call money market. Similarly, the extra liquidity which has been brought in the system by means of participation certificates has also led to its control by the Reserve Bank. Because of the vastness of the country, the call money market without brokers can at best take care of only imbalances in liquidity within specific centres. In the country as a whole there may still be pockets with surplus liquidity while certain other centres may be needing funds. Moreover, the admittance of the non-banking institutions like Life Insurance Corporation, Unit Trust of India, etc., in the money market/participation certificates also infuses additional funds in the system not subject to the control of the Reserve Bank of India. While there was every justification for ensuring that the funds from the non-banking system over which the Reserve Bank has no control should not defeat the credit control measures of the Reserve Bank of India, there is no reason why the liquidity imbalances in the banking system, *inter se*, should not be evened out, if it could be done without affecting the monetary policies of the Reserve Bank of India.

Extent of the floating funds in the money market

6.3 Call money borrowings of scheduled commercial banks in India ranged mostly between Rs. 200 crores to Rs. 300 crores during 1978 and 1979, of which the share of the non-banking institutions like LIC, UTI, etc., ranged generally between Rs. 50 crores to Rs. 100 crores. In addition, the participation cerificates issued by banks ranged between Rs.150 crores to Rs. 300 crores in 1977 and Rs. 350 crores to Rs. 560 crores during 1978 and upto March 1979. The participation certificates were issued by banks and purchased by institutions like Insurance Corporations, Unit Trust of India, other banks, Industrial Credit and Investment Corporation of India Ltd., etc. The total floating funds by way of call money and participation certificates in the banking system would be of the order of Rs. 800 crores, of which the inter-bank share would be roughly only about Rs. 200 crores. If the monetary authorities can control use of these floating funds by the banking system, it can very effectively control the funds available to the banking system for making advances, thus making the credit regulation effective. With the control over participation certificates, at present there is no other free short-term financial instrument in the money market. Accepted bank bills can fill in the vacuum to some extent. The position indicated above emphasises the need for creation of an institution on the lines of a discount house but with limited and regulated functions. Such an institution will regulate and facilitate call money operations and also develop the market for bills in the country.

Market for Government securities

6.4 At present the market in Government and Government guaranteed securities (including Treasury Bills) is not very active. This often creates operational problems for banks in complying with the liquidity requirements of the Reserve Bank. If an active market can be developed for these securities, it will be advantageous to the banks for their cash management. The proposed institution may help in this direction as well.

U. K. Discount Houses*

6.5 Before examining the scope and functions of the proposed discount house, its constitution and resources, it may be desirable to give a brief account of the discount houses operating in U. K. The London Discount Market's chief function is to provide the banking system with safe and profitable liquidity. The market does this by being ready at all times to borrow and to repay at call (*i. e.*, on demand) large sums of money against security. They, as a rule, do not deal directly with the public, but are in a sense bankers to banks, acting as depositories of the call money of the banking system. The discount houses in U. K. invest their funds in British Government and other high class short dated instruments. They are invariably willing to purchase for immediate settlement similar securities. They thus provide a secure home for overnight and short-term funds and also deal substantially in the varied short-term assets which constitute these portfolios. Bank of England controls the credit base of the banks by requiring them to invest a proportion of their funds in 'reserve assets'. The discount houses play a crucial role in this system, as money at call with the market and many of the instruments traded by the market qualify as 'reserve assets.' The Bank of England is able to influence the flow of 'reserve assets' by its operations with the Discount Market and the discount houses are often the first to sense the monetary stance of the authorities. As they are important arbiters of the rates at which these instruments are traded, action at the centre spreads to the periphery. The Bank of England finds it convenient to apply pressure in several ways on the small central cogwheel that is the Discount Market, knowing that the effects will be immediately transmitted through the huge machinery of banking business. Should the Bank of England be content for rates to fall, it may take no particular action other than maintaining easy conditions in the money market and indicating in its daily operations with the Discount Houses its willingness for rates to fall. Competition and profit motive will continue the process until the Bank signals a change of attitude. If, however, the Bank wishes to see the rates to rise, it can in the first place adopt higher rates for its own treasury transactions with the market. But much more potent is its action by refusing to buy Treasury Bills at all when the money is short and instead forcing the discount houses to borrow the money they require for 7 days at what amounts to stiffer rate.

Discount house for India

6.6 A sophisticated money market with its dependence on interest mechanism for controlling liquidity as is operating in U. K. may not be ideal for India. Still the manner in which the discount houses operate in U. K. can be profitably made applicable to Indian conditions as well. According to the available data, as at the end of December 1974 nearly 80 per cent of the resources of the discount houses in U.K.

* The material for this paragraph has been taken from the following sources :
1. "The London Discount Market" by Gerrard & National Discount Co. Ltd., London.
2. "The Discount Houses in London" by G. A. Fletcher.

came from London Clearing Banks as well as other banks and acceptance houses. Out of the assets held, treasury bills, other sterling bills (mostly commercial bills), sterling cerificates of deposits, local authority securities, etc., accounted for over 80 per cent of the total assets.

6.7 The proposed discount house in India should perform the following functions :

Functions of the proposed disco-unt house

(*a*) Collection of the surplus liquid funds of the banking system as well as the non-banking financial institutions through a central agency like the proposed discount house with branches initially at important commercial centres like Bombay, Calcutta, Madras, New Delhi and Bangalore. In centres where it operates, it will be the sole depository of such short-term funds of banks and specified non-banking financial institutions.

(*b*) Use of surplus funds to even out the imbalances in liquidity in the banking system subject to such general guidelines as Reserve Bank may deem it fit to issue from time to time.

(*c*) Creation of a ready market for commercial bills, treasury bills and Government/Government guaranteed securities by being ready to purchase from and sell to the banking system such securities.

Constitution of the Discount House

6.8 As it would be a new experiment in the country, it is sufficient to have only one discount house initially. The institution may be sponsored by its main users, i.e., the commercial banks and non-banking institutions like LIC, UTI and GIC. The term lending institutions like IDBI, ICICI, SFCs, etc., can also participate. The institution should be an autonomous body to run on strictly commercial principles within the overall monetary and credit policies of the Reserve Bank of India. Its Board should have expertise in credit analysis and operations on the call money and stock exchange markets. The Reserve Bank should have powers to give directions to the corporation as and when necessary. The corporation should have also power to borrow from the Reserve Bank when required.

6.9 The corporation would derive its funds from :

Resources and uses of funds

(*a*) its own capital and operating profits.

(*b*) borrowings from the commercial banks and non-banking institutions like LIC, UTI, GIC, term lending institutions, etc., on call or short notice basis (It will not have any direct dealing with the public).

(*c*) borrowings from the Reserve Bank.

The funds should be utilised for :

(*a*) Investment in treasury bills and Government and other trustee securities,

(*b*) Commercial bills accepted by banks, and

(*c*) Working balance with the Reserve Bank of India.

The liability and assets pattern can be reviewed from time to time and additional sources as well as uses can be found with the consent of the Reserve Bank of India. The open market operations that are being conducted by the Reserve Bank of India at present can be transferred to the proposed discount house to the extent possible.

Link with the Reserve Bank

6.10 The Reserve Bank should have powers to give directions to the discount house and the discount house will have to maintain a very close relationship with the Reserve Bank. The Reserve Bank could regulate the flow of funds in the economy by means of its overall control over the operations of the discount house, though its day-to-day operations would be free from the control of the Reserve Bank. As the proposed discount house would be functioning in close co-ordination with the commercial banks and under the control of the Reserve Bank of India, the investments made by banks with the discount house should be treated as liquid assets for the purpose of liquidity requirements under the law.

Details to be worked out

6.11 The Group has described in the foregoing paragraphs the need for creation of an autonomous financial institution on the lines of a discount house in order to replace the system of brokers in call money and Government securities market and has also indicated certain broad framework for such an institution. It would be necessary to work out the details, once the idea is accepted in principle.

CHAPTER VII

Other Recommendations

Other issues

7.1 During the discussions with bankers and borrowers several other suggestions have been given to the Group, some of which do not form the subject matter of the report. The suggestions having a bearing on the terms of reference of the Group are dealt with in the following paragraphs.

Correlation between production and bank finance

7.2 In the terms of reference to the Group, a reference has been made to the effect that the credit extended should, *inter alia*, be related to increases in output and other productive activities. The Group has not been able to procure any conclusive data to establish the degree of correlation between production and the quantum of credit at the industry level. Apparently in the short run at least there is no such definite relationship between industrial production and level of credit. The short-term fluctuations in the credit are more often due to seasonal factors, unforeseen contingencies and imponderables of the economy over which the borrower may not have any control. In the long run, however, there should be obviously a definite relationship between industrial production and increase in credit to the industrial sector. It may not be correct to relate increase in bank credit to increase in physical output only, as bank finance depends not only upon increase in physical output but also the price level. A study of bank borrowings in relation to the increase in the index of industrial output in conjunction with the price index may not, however, reflect the precise position, as the weightage given in the price index would probably distort the picture to some extent. The Group understands that some attempts have been made in the past to study the increase in bank borrowings in relation to industrial output in conjunction with the price level index. Because of the limitations implicit in such a system of comparison and as the data were comparatively old, the Group has not been able to make use of such studies. As this issue is obviously of great concern to the monetary authorities and as the question has often been raised in the context of the increases in bank borrowings, the Group recommends that the Reserve Bank may undertake a detailed scientific study of this aspect.

Communication of credit control measures to branches and follow-up

7.3 As indicated in paragraph 2.4, credit control measures to be effective will have to be immediately communicated to the operational level and followed up. It may not be possible for the controlling offices of the banks to regulate credit without the active co-operation at the operational level. There should be a 'cell' attached to the Chairman's office at the Central Office of each bank which may handle such matters. Immediately following the announcement of changes in credit regulation by the Reserve Bank, the special cells in the Head Offices of banks should arrange to instruct the branches expeditiously, particular attention being paid to the 'key' branches which, in practically every bank, account for a large portion of the advances. There should also be a system for monitoring the implementation of such instructions. Almost all the bigger banks do their planning exercise over a year. The budgets are

drawn up in advance and courses of action for implementing the budgetary proposals are also initiated in advance. The Central Offices of banks should take a second look at the credit budget as soon as changes in credit policy are announced and revise their plan of action in the light of the new policy and communicate the corrective measures to the operational levels as quickly as possible.

Monitoring of key branches and critical accounts

7.4 Irrespective of the fact whether there is a change in credit policy or not, the banks should continuously monitor the credit portfolio of the 'key' branches. Although the banking system as a whole has about 29500 branches, it is observed that a small percentage of branches particularly at a few large centres would account for a substantial portion of advances. As a matter of fact, the branches at fifteen large centres account for more than 60 per cent of the total advances of the banking system. From the data of fresh/additional limits of Rs. 50 lakhs and above granted during the period end-November 1978 and end-March 1979, the Group has observed that the bulk of the increased limits as well as drawings has been shared by a few important centres like Bombay, Calcutta, Madras and New Delhi. The key branches may, however, vary from bank to bank. If a bank, therefore, gives particular attention to its 'key' branches, it will be able to manage its credit portfolio more meaningfully than by attempting to equally oversee all its branches at the same time. This of course does not relate to the normal follow-up measures introduced by banks to control individual advances at all branches.

It was indicated in paragraph 2.5 that banks should improve their information and monitoring system in respect of the medium and large borrowers. Large corporate borrowers could be classified into three distinct categories (*i*) seasonal, (*ii*) non-seasonal, non-critical and (*iii*) critical. The fluctuations in the credit requirements of the seasonal borrowers are more or less amenable to accurate forecasts. The 'non-seasonal, non-critical' advances comprising the bulk of the borrowers would not be showing any wide fluctuations and their demands are also easily assessable. The remaining category comprising critical accounts may show wide fluctuations in their operations. For effective credit monitoring, it would be adequate if these accounts are kept under a close watch. The number of such accounts in each bank should not be large and the banks can by experience identify critical accounts. If they constantly monitor such accounts by keeping a watch over the utilisation of limits and inventory build-up, the purpose of credit management would be served to a large extent.

Delay in collection of bills/cheques

7.5 It has been represented by industry representatives that large amounts of their resources get blocked, because of the delay in collection of bills and cheques, return of documents by the collecting branches, etc. The Group is of the view that such delays should be reduced to the minimum and recommends that the communication channels and systems and procedures within the banking system should be toned up so as to ensure that minimum time is taken for collection, etc.

Bills facilities and current accounts with other banks

7.6 Banks usually object to their borrowers dealing with other banks without their specific consent. It is, however, learnt that some borrowers still maintain current accounts and arrange bills facilities with other banks. Apart from diluting the control over the advance by the main banker, this practice often enables the borrower to divert sales proceeds for unapproved purposes without the knowledge of his main banker. This is an unhealthy practice and banks may be suitably advised in this matter by the Reserve Bank.

CHAPTER VIII

Summary of recommendations

1. The advantages of the existing system of extending credit by a combination of the three types of lending, *viz.*, cash credit, loan and bill should be retained. At the same time it is necessary to give some directional changes to ensure that wherever possible the use of cash credit would be supplanted by loans and bills. It would also be necessary to introduce necessary corrective measures to remove the impediments in the use of bill system of finance and also to remove the drawbacks observed in the cash credit system (paragraph 4.22).

2. Bifurcation of cash credit limit into a demand loan portion and a fluctuating cash credit component has not found acceptance either on the part of the banks or the borrowers. Such bifurcation may not serve the purpose of better credit planning by narrowing the gap between sanctioned limits and the extent of utilisation thereof. It is not likely to be voluntarily accepted and it does not confer enough advantages to make it compulsory (paragraphs 5.2 and 5.4).

3. The need for reducing the over-dependence of the medium and large borrowers—both in the private and public sectors—on bank finance for their production/trading purposes is recognized. The net surplus cash generation of an established industrial unit should be utilised partly at least for reducing borrowing for working capital purposes (paragraph 5.7).

4. In order to ensure that the borrowers do enhance their contributions to working capital and to improve their current ratio, it is necessary to place them under the Second Method of lending recommended by the Tandon Committee which would give a minimum current ratio of 1.33:1. As many of the borrowers may not be immediately in a position to work under the Second Method of lending, the excess borrowings should be segregated and treated as a working capital term loan which should be made repayable in instalments. To induce the borrowers to repay this loan, it should be charged a higher rate of interest. For the present, the Group recommends that the additional interest may be fixed at 2 per cent per annum over the rate applicable on the relative cash credit limits. This procedure should be made compulsory for all borrowers (except sick units) having aggregate working capital limits of Rs. 10 lakhs and over (paragraph 5.9).

5. While assessing the credit requirements, the bank should appraise and fix separate limits for the 'normal non-peak level' as also for the 'peak level' credit requirements indicating also the periods during which the separate limits would be utilised by the borrower. This procedure would be extended to all borrowers having working capital limits of Rs. 10 lakhs and above. One of the important criteria for deciding such limits should be the borrowers' utilisation of credit limits in the past (paragraphs 5.10 to 5.12).

6. If any *ad hoc* or temporary accommodation is required in excess of the sanctioned limit to meet unforeseen contingencies the additional finance should be given, where necessary, through a separate demand loan account or a separate 'non-operable' cash credit account. There should be a stiff penalty for such demand loan or 'non-operable' cash credit portion, at least two per cent above the normal rate, unless Reserve Bank exempts such penalty. This discipline may be made applicable in cases involving working capital limits of Rs. 10 lakhs and above (paragraphs 5.13 and 5.14).

7. The borrower should be asked to give his quarterly requirement of funds before the commencement of the quarter on the basis of his budget, the actual requirement being within the sanctioned limit for the particular peak level/non-peak level periods. Drawings less than or in excess of the operative limit so fixed (with a tolerance of 10 per cent either way) but not exceeding sanctioned limit would be subject to a penalty to be fixed by the Reserve Bank from time to time. For the time being, the penalty may be fixed at 2 per cent per annum. The borrower would be required to submit his budgeted requirements in triplicate and a copy each would be sent immediately by the branch to the controlling office and Head Office for record. The penalty would be applicable only in respect of parties enjoying credit limits of Rs. 10 lakhs and above, subject to certain exemptions (paragraphs 5.15 to 5.20).

8. The non-submission of the returns in time is partly due to certain features in the forms themselves. To get over this difficulty, simplified forms have been proposed. As the quarterly information system is part and parcel of the revised style of lending under the cash credit system, if the borrower does not submit the return within the prescribed time, he should be penalised by charging the whole outstandings in the account at a penal rate of interest, one per cent per annum more than the contracted rate for the advance from the due date of the return till the date of its actual submission (paragraph 5.21).

9. Requests for relaxation of inventory norms and for *ad hoc* increases in limits should be subjected by banks to close scrutiny and agreed to only in exceptional circumstances (paragraph 5.22).

10. The banks should devise their own check lists in the light of the instructions issued by the Reserve Bank for the scrutiny of data at the operational level (paragraph 5.23).

11. Delays on the part of banks in sanctioning credit limits could be reduced in cases where the borrowers co-operate in giving the necessary information about their past performance and future projections in time (paragraph 5.24).

12. As one of the reasons for the slow growth of the bill system is the stamp duty on usance bills and difficulty in obtaining the required denominations of stamps, these questions may have to be taken up with the State Governments (paragraph 5.25).

13. Banks should review the system of financing book debts through cash credit and insist on the conversion of such cash credit limits into bill limits (paragraph 5.26).

14. A stage has come to enforce the use of drawee bills in the lending system by making it compulsory for banks to extend at least 50 per cent of the cash credit limit against raw materials to manufacturing units whether in the public or private sector by way of drawee bills. To start with, this discipline should be confined to borrowers having aggregate working capital limits of Rs. 50 lakhs and above from the banking system (paragraphs 5.27 and 5.29).

15. Banks should insist on the public sector undertakings/large borrowers to maintain control accounts in their books to give precise data regarding their dues to the small units and furnish such data in their quarterly information system. This would enable the banks to take suitable measures for ensuring payment of the dues to small units by a definite period by stipulating, if necessary, that a portion of limits for bills acceptance (drawee bills) should be utilised only for drawee bills of small scale units (paragraph 5.30).

16. To encourage the bill system of financing and to facilitate call money operations an autonomous financial institution on the lines of the Discount Houses in U. K. may be set up (paragraphs 6.1 to 6.11).

17. No conclusive data are available to establish the degree of correlation between production and quantum of credit at the industry level. As this issue is obviously of great concern to the monetary authorities the Reserve Bank may undertake a detailed scientific study in this regard (paragraph 7.2).

18. Credit control measures to be effective will have to be immediately communicated to the operational level and followed up. There should be a 'Cell' attached to the Chairman's office at the Central Office of each bank to attend to such matters. The Central Offices of banks should take a second look at the credit budget as soon as changes in credit policy are announced by the Reserve Bank and revise their plan of action in the light of the new policy and communicate the corrective measures to the operational levels as quickly as possible (paragraph 7.3).

19. Banks should give particular attention to monitor the key branches and critical accounts (paragraph 7.4).

20. The communication channels and systems and procedures within the banking system should be toned up so as to ensure that minimum time is taken for collection of instruments (paragraph 7.5).

21. Although banks usually object to their borrowers dealing with other banks without their consent, some of the borrowers still maintain current accounts and arrange bill facilities with other banks, which vitiate the credit discipline. Reserve Bank may issue suitable instructions in this behalf (paragraph 7.6).

K. B. Chore
Chairman

S. P. Chandavarkar
Member

Kum. M. Tyagarajan
Member

V.Mahadevan
Member

R. P. Vaidya
Member

M. L. Inasu
Member-Secretary

Bombay, 31st August 1979.

APPENDIX I

RESERVE BANK OF INDIA

CENTRAL OFFICE

DEPARTMENT OF BANKING OPERATIONS & DEVELOPMENT

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MEMORANDUM

In pursuance of the decision taken at the meeting which the Governor had with Chairmen of some of the major banks on March 15, 1979, the Reserve Bank of India appoints the following persons to constitute a Working Group to review the system of cash credit by banks in all its aspects:

1. SHRI K. B. CHORE,
Additional Chief Officer,
Department of Banking Operations and Development,
Reserve Bank of India,
Central Office,
Bombay .. .. *Chairman*

2. SHRI S. P. CHANDAVARKAR,
Senior Deputy General Manager,
Union Bank of India,
Bombay .. .. *Member*

3. SHRI V. MAHADEVAN,
General Manager (Planning),
Local Head Office,
State Bank of India,
Bombay .. .. *Member*

4. SHRI R. P. VAIDYA,
Deputy General Manager,
Bank of India,
Bombay .. .. *Member*

5. KUM. M. TYAGARAJAN,
Director,
Economic Department,
Reserve Bank of India,
Bombay, ... *Member*

and

6. SHRI M. L. ÌNASU,
Joint Chief Officer,
Department of Banking Operations and Development,
Reserve Bank of India,
Central Office,
Bombay .. .. *Member-Secretary*

(**Appendix I**—*Contd.*)

2. The terms of reference of the Working Group are as follows :

(*i*) To review the operation of the cash credit system in recent years, particularly with reference to the gap between sanctioned credit limits and the extent of their utilisation;

(*ii*) In the light of the review, to suggest :

(*a*) modifications in the system with a view to making the system more amenable to rational management of funds by commercial banks, and/or

b) alternative types of credit facilities, which would ensure greater credit discipline and also enable banks to relate credit limits to increases in output or other productive activities, and

(*iii*) To make recommendations on any other related matter as the Group may consider germane to the subject.

3. The Working Group is expected to submit its Report by May 15, 1979.

4. The Secretariat for the Working Group will be provided by the Department of Banking Operations and Development, Central Office, Reserve Bank of India, Bombay 400 005.

Sd.
(K. S. KRISHNASWAMY)
DEPUTY GOVERNOR
4-4-1979

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APPENDIX II

RESERVE BANK OF INDIA

CENTRAL OFFICE

Post Box No. 6089

DEPARTMENT OF BANKING OPERATIONS AND DEVELOPMENT
"THE ARCADE", WORLD TRADE CENTRE,
CUFFE PARADE, COLABA, BOMBAY 400 005

Ref. DBOD. No. CAS(COD) 94/WGCC-79

April 9, 1979
Chaitra 19, 1901 (Saka)

Addressed to 27 major banks,

Dear Sir,

Working Group to review the system of cash credit

In pursuance of the decision taken at the meeting of the Governor with Chairmen of some of the major banks on the 15th March 1979, a Working Group to review the system of cash credit by banks has been constituted by the Reserve Bank of India. One of the tasks assigned to the Group is to review the operation of the cash credit system with reference to the gap between the sanctioned credit limits and the extent of their utilisation. In this connection, we shall be glad if you will kindly arrange to forward to us *urgently* the information called for in Annexure I.

2. You are also requested to make immediately a sample study of the utilisation of cash credit/ overdraft limits during the years 1977, 1978 and upto end-March 1979 in at least 25 accounts in each of the following categories of borrowers engaged in different types of activities.

Borrowers enjoying credit limits —

(*a*) Between Rs. 10 lakhs and upto Rs. 1 crore
(*b*) Above Rs. 1 crore and upto Rs. 5 crores
(*c*) Above Rs. 5 crores and upto Rs. 10 crores
(*d*) Above Rs. 10 crores

The study should cover the limits sanctioned to these parties over the period indicated above, the drawing power available in the accounts and the extent of utilisation of such limits. The parties selected for the study should cover a representative segment of the bank's non-food borrowers excluding sick units and should include both the public and private sectors engaged in trading, manufacturing and other types of activities. The results of the study may be communicated to us in the pro-forma enclosed (Annexure II), together with your observations.

3. In view of the urgency of the data, we shall be glad if you will kindly give the matter *top priority* and furnish the figures as and when they are ready. You are particularly requested to send us the information regarding item I(*a*) (*b*) and (*c*) of Annexure I so as to reach us *positively* before the 21st of this month and the remaining data before the end of this month.

Yours faithfully
Sd.
(M. L. Inasu)
Joint Chief Officer

(**Appendix II**—*Contd.*)

Annexure I

I. In the Governor's circular CPC. No. BC/31/279A-78 dated the 30th November 1978, banks were advised to plan their future expansion of non-food credit so that the incremental gross credit (non-food)—deposit ratio for the period December 1, 1978 to end-March 1979 would be well within 40%.

In this connection, please let us know :—

(*a*) The precise steps taken by your bank to implement the above instructions indicating the dates on which such steps were taken.

(*b*) If your bank could not comply with these instructions, what were the reasons for non-compliance ? Data in support of these reasons to the extent readily available should also be given.

(*c*) Has the bank identified the causes for the increase in its advances? What are these ? Please also indicate the increase in the advances from the 1st December 1978 to end-March 1979, to

(*i*) Priority sectors
(*ii*) Export sector
(*iii*) Other sectors

II. In respect of *increase* in the outstanding advances between 1st December 1978 and 31st March 1979, please furnish particulars of the borrowers who were given fresh and/or additional working capital limits of Rs. 50 lakhs and above during the above period in the form given below :

(Amounts in lakhs of rupees)

Name of borrower	Centre	Constitution	Type of of activity	As at the end of November 1978				
				Aggregate cash credit/ O. D. limit	Drawing power	Balance	Other working capital limits	Balance
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

As at the end of March 1979				
Aggregate cash credit/O. D. limit	Drawing power	Balance	Other working capital limits	Balance
(10)	(11)	(12)	(13)	(14)

Note : If the figures are not available at the Head Office for the bank as a whole, these may be obtained from selected number of branches which account for a major portion of the *increase* in advances.

(**Appendix II**—*Contd.*)

Annexure II

Name of bank ——————————————————

(Amounts in lakhs of rupees)

Name of borrower (1)	Centre (2)	Constitution (3)	Type of activity (4)

Particulars as at the end of

March 1977			September 1977			March 1978		
S.L. (5)	D. P. (6)	Bal. (7)	S.L. (8)	D.P. (9)	Bal. (10)	S.L. (11)	D.P. (12)	Bal. (13)

Particulars as at the end of

September 1978			November 1978			March 1979		
S.L. (14)	D.P. (15)	Bal. (16)	S.L. (17)	D.P. (18)	Bal. (19)	S.L. (20)	D.P. (21)	Bal. (22)

S. L. = Sanctioned limit

D.P. = Drawing power

Bal. = Balance outstanding

This statement should relate to only cash credits/over drafts.

APPENDIX—III

Names of Parties who met/forwarded their views to the Working Group

I. Chambers of Commerce and Industry/Industry Association :

1. Federation of Indian Chambers of Commerce and Industry, New Delhi.
2. Indian Cotton Mills Federation, Bombay.
3. Bengal Chamber of Commerce, Calcutta.
4. Bengal National Chamber of Commerce, Calcutta.
5. Bharat Chamber of Commerce, Calcutta.
6. Indian Jute Mills Association, Calcutta.
7. Tea Association of India, Calcutta.
8. Indian Tea Planters' Association, Calcutta.
9. Bharatiya Cha Parishad, Calcutta.
10. Gujarat Chambers of Commerce and Industries, Ahmedabad.
11. Ahmedabad Mill Owners' Association, Ahmedabad.
12. Maskati Cloth Market Association, Ahmedabad.
13. Ahmedabad Industrial Estate Factory Owners Association, Ahmedabad.
14. Ahmedabad Engineering Manufacturers Association, Ahmedabad.
15. Ahmedabad Cotton Merchants Association, Ahmedabad.
16. Gujarat State Plastic Manufacturers Association, Ahmedabad.
17. Vatva Industries Association, Ahmedabad.
18. Southern India Chamber of Commerce & Industry, Madras.
19. Madras Chamber of Commerce & Industry, Madras.
20. Tamil Nadu Industrial Development Corporation, Madras.
21. Tamil Nadu Small Scale Industries Association, Madras.
22. Andhra Chamber of Commerce, Madras.
23. Industrial Estate Manufacturers Association, Madras.
24. Hindustan Chamber of Commerce, Madras.
25. Federation of Karnataka Chamber of Commerce and Industries, Bangalore.
26. Karnataka Small Scale Industries Association, Bangalore.
27. Punjab, Haryana and Delhi Chambers of Commerce and Industries, New Delhi.
28. Federation of Associations of Small Industries of India, New Delhi.
29. Associated Chambers of Commerce and Industries of India, New Delhi.
30. All India Manufacturers Organisation, New Delhi.
31. Federation of Indian Manufacturers, New Delhi.
32. National Alliance of Young Entrepreneurs, New Delhi.
33. Delhi Factory Owners Association, New Delhi.
34. Association of Merchants and Manufacturers of Textile Stores and Machinery (India), Bombay.
35. Indian Chamber of Commerce, Calcutta.
36. Bombay Chamber of Commerce and Industry, Bombay.
37. Indian Tea Association, Calcutta.
38. Association of Chambers of Commerce, Bombay.
39. Gujarat State Co-operative Marketing Federation, Ahmedabad.
40. Technician Entrepreneurs Association, Ahmedabad.
41. Federation of Gujarat Mills and Industries, Baroda.

II. Management Institute/Training Institute, etc.

1. National Institute of Bank Management, Bombay.
2. Institute of Chartered Accountants of India, New Delhi.
3. Bankers Training College, Bombay.
4. Committee of Direction for Follow-up of Bank Credit.
5. Bangalore Management Association, Bangalore.

III. Bankers' Association

Indian Banks' Association, Bombay.

IV. Banks

1. State Bank of India.
2. Allahabad Bank.
3. Bank of India.
4. Bank of Baroda.

(**Appendix III**—*Contd.*)

5. Bank of Maharashtra.
6. Canara Bank.
7. Central Bank of India.
8. Dena Bank.
9. Indian Bank.
10. Indian Overseas Bank.
11. Punjab National Bank.
12. Syndicate Bank.
13. Union Bank of India.
14. United Bank of India.
15. United Commercial Bank.
16. Grindlays Bank Ltd.
17. Citibank.
18. American Express International Banking Corporation.
19. Bank of America N. T. and S. A.
20. State Bank of Mysore.
21. Corporation Bank Ltd.
22. Vijaya Bank Ltd.
23. Vysya Bank Ltd.
24. Karnataka Bank Ltd.
25. Lakshmi Vilas Bank Ltd.
26. Laxmi Commercial Bank Ltd.
27. State Bank of Patiala
28. Punjab & Sind Bank Ltd.
29. New Bank of India Ltd.
30. Oriental Bank of Commerce Ltd.
31. State Bank of Bikaner & Jaipur.
32. Bank of Madura Ltd.
33. Bharat Overseas Bank Ltd.
34. State Bank of Saurashtra.

V. Individuals

1.	SHRI P. F. GUTTA	Central Bank of India
2.	PROF. N. L. HINGORANI	National Institute of Bank Management, Bombay
3.	,, SAMPAT SINGH	do
4.	,, S. D. VARDE	do
5.	SHRI S. L. N. SIMHA	Institute for Financial Management & Research Madras
6.	,, N. R. KULKARNI	Hindustan Motor Ltd., Calcutta
7.	,, R. C. MAHESHWARI ..	Texmaco Ltd., Calcutta
8.	,, B. V. SONALKAR	Bank of India
9.	,, K. N. R. RAMANUJAM ..	Indian Bank
10.	,, S. N. S. RAGHAVAN ..	Grindlays Bank Ltd.
11.	,, N. SUNDER	Hindustan Lever
12.	,, V. J. MENEZES	Citibank
13.	,, A. GHOSH	Allahabad Bank
14.	,, M. B. DUTTA	State Bank of Bikaner & Jaipur
15.	,, D. C. GUPTA	Punjab National Bank
16.	,, S. B. PARDIWALA ..	Vijaya Bank Ltd.
17.	,, L. D. KHANNA	State Bank of Patiala
18.	,, K. VENKATARAMA AYYAR	Indian Bank
19.	,, C. E. KAMATH	Canara Bank

VI. Others

1. Tea Industry, Calcutta
2. Indian Telephone Industries
3. Hindustan Machine Tools
4. New Government Electric Factory
5. Visveswaraya Iron and Steel Ltd.
6. Escorts Ltd.
7. Delhi Cloth & General Mills Co. Ltd.
8. Bharat Steel Tubes Ltd. .. ..
9. Ranbaxy Laboratories Ltd. ..
10. Mohan Meakin Breweries Ltd.
11. Modi Industries

(**Appendix III**—*Concld.*)

12. Jain Tube Co.
13. Harsha Tractors Ltd.
14. Sudarshan Steel Rolling Mills.
15. Hindustan Electrographite Ltd.
16. Fedders Lloyd Corporation (Pvt.) Ltd.
17. Paliwal Steels (P) Ltd.
18. Tools & Equipments (Pvt.) Ltd.
19. Ishwar Industries Ltd.
20. Talbros Automative Components Ltd.
21. Autonetic Engineering (P) Ltd.
22. Bajaj Mechanical.
23. Bharat Heavy Electricals Ltd.
24. State Trading Corporation.
25. Minerals & Metals Trading Corporation of India Ltd.
26. Ballarpur Industries Ltd.
27. Tata Engineering & Locomotive Company Ltd.
28. Associated Cement Cos. Ltd.
29. Indian Explosives
30. Atlas Cycle Industries
31. Birla Cotton Mills
32. Modipon Ltd.
33. Neyveli Lignite Corporation
34. Anil Starch Products Ltd.

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APPENDIX IV

STATEMENTS

Statement No.	Description
1.	Distribution of outstanding credit of scheduled commercial banks according to type of account — BSR Data
2.	Non-food credit limits and outstanding credit — CAS Form 'A' Data — Quarterly
3.	Variation in utilisation of cash credit limits between June 1976 and June 1977 — Industry-wise — BSR Data
4.	Utilisation of cash credit limits — Industrywise — CAS Form 'A' Data
5.	Cash credits, overdrafts and demand loans (non-food) classified according to sector—CAS Form 'A' Data
6.	Distribution of outstanding credit of scheduled commercial banks according to the size of the credit limit — BSR Data
7.	Sizewise percentage utilisation of credit limits — CAS Form 'A' Data

(APPENDIX IV— *Contd.*)

Statement I—Distribution of outstanding credit of scheduled commercial banks according to the type of account — BSR Data

(Amount in lakhs of rupees)

Type of account	As on the last Friday of						Percentage increase	
	June 1973			June 1977				
	Credit limits 1	Amount outstanding 2	Utilisation (per cent) 3	Credit limits 4	Amount outstanding 5	Utilisation (per cent) 6	Credit limits 7	Amount Outstanding 8
Cash Credits	506402 (48.6)	288675 (50.0)	57.0	823850 (44.6)	544822 (45.2)	66.1	62.7	88.7
Overdrafts	89683 (8.6)	46459 (8.1)	51.8	126057 (6.8)	75294 (6.2)	59.7	40.6	62.1
Demand loans	53983 (5.2)	34862 (6.0)	64.6	79719 (4.3)	62089 (5.2)	77.9	47.7	78.1
Packing credit	53216 (5.1)	29491 (5.1)	55.4	94914 (5.1)	52717 (4.4)	55.5	78.4	78.8
Inland bills purchased/discounted	165763 (15.9)	79939 (13.9)	48.2	341786 (18.5)	224814 (18.6)	65.8	106.2	181.2
Export bills purchased/discounted/advanced against	48927 (4.7)	22326 (3.9)	45.6	83577 (4.5)	43704 (3.6)	52.3	70.8	95.7
Advances against import bills	24358 (2.3)	3524 (0.6)	14.5	66718 (3.6)	6536 (0.5)	9.8	173.9	85.5
Term loans	97376 (9.3)	70572 (12.2)	72.5	233651 (12.6)	196411 (16.3)	84.1	139.9	178.3
Unclassified	3054 (0.3)	1265 (0.2)	41.4	1 (—)	1 (—)	100.0	..	..
	1042762 (100.0)	577113 (100.0)	55.3	1850273 (100.0)	1206388 (100.0)	65.2	77.4	109.0

Figures in brackets indicate percentages to the total.

(APPENDIX IV *Contd.*)

Statement No. 2— Non-food credit limits and outstanding credit — CAS Form 'A' Data — Quarterly

(Amount in crores of rupees)

Last Friday of	All facilities*			Cash credits, overdrafts and demand loans			Cash credits, overdrafts and demand loans limits as percentage of limits for all facilities	Amount outstanding against cash credits, overdrafts & demand loans as percentage of total outstanding against all facilities
	Credit limits	Amount outstanding	Utilisation (per cent)	Credit limits	Amount outstanding	Utilisation (per cent)		
	1	2	3	4	5	6	7	8
March 1977	6945	4319	62.2	4609	2893	62.8	66.4	67.0
June 1977	7324	4225	57.7	4631	2757	59.5	63.2	65.2
September 1977	7284	4389	60.3	4605	2874	62.4	63.2	65.4
December 1977	7517	4739	63.0	4833	3148	65.1	64.3	66.4
March 1978	7763	4826	62.2	5096	3217	63.1	65.6	66.7
June 1978	8268	5143	62.2	5329	3376	63.4	64.5	65.6
September 1978	8400	5241	62.4	5477	3434	62.7	65.2	65.5
December 1978	8702	5765	66.2	5579	3785	67.8	64.1	65.7
March 1979	9000	5753	63.9	5733	3688	64.3	63.7	64.1

*Apart from cash credits, overdrafts and demand loans, these include (*a*) packing credit (*b*) export bills (*c*) term loans (*d*) inland bills (*e*) sales on deferred payment basis under IDBI scheme.

(APPENDIX IV *Contd.*)

Statement No. 3 :—Variation in utilisation of cash credit limits between June 1976 and June 1977—Industrywise—BSR Data

INDUSTRY	As on the last Friday of					
	June 1976			June 1977		
	Number of accounts (1)	Credit limits (Rs. in lakhs) (2)	Utilisation (per cent) (3)	Number of accounts (4)	Credit limits (Rs. in lakhs) (5)	Utilisation (per cent) (6)
I. Agriculture and allied activities						
1. Agriculture excluding plantations						
(*a*) Direct Finance ..	25030	12146	62.0	30919	12392	72.4
(*b*) Indirect Finance ..	11748	35184	54.3	12128	25839	60.9
2. Plantations	3991	17253	62.0	4037	17410	48.6
II. Industry						
A. Mining & Quarrying ..	1267	15252	59.4	1263	15437	66.4
B. Manufacturing						
1. Food Manufacturing and Processing						
(*a*) Rice Mills, Flour and Dal Mills	4252	9022	38.6	4788	9790	38.7
(*b*) Sugar	564	32387	51.5	670	36835	55.7
(*c*) Edible Oils & Vanaspati	2845	10818	42.6	3059	11118	48.8
(*d*) Others	3428	9382	59.1	3646	11049	71.3
2. Beverage and Tobacco	1841	9272	60.1	1937	10374	71.1
3. Textiles						
(*a*) Cotton Textiles ..	9111	67661	67.9	9891	66120	79.5
(*b*) Jute Textiles ..	262	8431	62.1	244	9311	72.7
(*c*) Other Textiles ..	11527	26898	67.9	13243	29454	67.0
4. Paper and paper products	7008	17401	70.9	7752	18259	70.7
5. Leather and leather-products	1693	2901	74.2	1904	3460	86.2
6. Rubber and rubber products	2177	10349	72.2	2432	12152	62.5
7. Chemicals and chemical products						
(*a*) Heavy industrial chemicals	464	6712	58.4	443	5939	70.8
(*b*) Fertilisers	541	13690	70.4	577	13559	50.9
(*c*) Drugs and Pharmaceuticals	2532	16778	51.8	2869	15212	65.8
(*d*) Others	11131	29334	66.2	12461	33148	66.8

(**APPENDIX IV** *Contd.*)

(Statement No. 3 *Concluded*)

INDUSTRY	As on the last Friday of June 1976: No. of accounts	June 1976: Credit limits (Rs. in lakhs)	June 1976: Utilisation (per cent)	June 1977: Number of accounts	June 1977: Credit limits (Rs. in lakhs)	June 1977: Utilisation (per cent)
	(1)	(2),	(3)	(4)	(5)	(6)
8. Manufacture of minerals	663	14697	23.9	726	10502	22.3
9. Cement	324	7460	67.1	330	6614	54.1
10. Basic Metal and Metal Products						
(*a*) Iron & Steel ..	5649	44099	74.8	5873	47929	65.0
(*b*) Others	11558	32015	54.9	12489	30521	63.7
11. Engineering						
(*a*) Heavy Engineering ..	3113	78473	70.4	3188	73289	64.2
(*b*) Light Engineering ..	14193	36215	73.1	15606	40793	71.7
12. Vehicles, vehicle parts and transport equipments	4858	39267	46.7	5251	27392	69.1
13. Others	28722	43440	61.2	32637	49321	70.5
C. Electricity Generation, Transmission and Distribution	1063	9971	56.6	1073	14860	39.8
D. Construction	4370	7105	79.3	5103	9052	78.7
E. Transport operators ..	9850	10575	56.1	11607	12742	55.8
F. Personal and professional services						
1. Professional services	3530	1719	68.2	4150	2048	64.9
2. Artisans & Craftsmen	1780	854	69.5	2107	988	76.2
3. Other services ..	6771	8187	64.7	7940	8507	64.7
III. **TRADE**						
1. Wholesale trade ..	52729	202612	65.4	56388	256731	69.9
2. Retail trade	52315	26260	63.8	61949	28418	67.9
IV. **Personal Loans** (including consumer durables) ..	**30746**	**11893**	**73.8**	**34840**	**12583**	**75.4**
V. **All Others**	**27882**	**42259**	**49.4**	**31281**	**40474**	**57.7**
TOTAL	**361528**	**967972**	**62.4**	**406801**	**1029626**	**66.2**

(APPENDIX IV *Contd.*)

Statement No. 4— Utilisation of cash credit limits — Industry wise — CAS Form 'A' Data

(per cent)

Industry	Last Friday of							
	June 1977	September 1977	December 1977	March 1978	June 1978	September 1978	December 1978	March 1979
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Agriculture								
Direct finance	27.6	45.1	52.1	48.8	12.1	7.6	54.6	36.8
Distribution of fertilisers	46.2	41.6	42.9	71.3	79.6	57.7	65.0	57.7
Others	42.4	48.6	25.1	17.5	71.9	76.5	76.0	82.2
Plantation								
Tea	47.9	38.0	37.8	40.9	50.3	50.2	55.0	49.0
Others	2.0	3.5	3.1	1.4	--	6.8	8.6	6.4
Mining & Quarrying								
Coal	48.4	47.2	61.2	51.6	54.6	52.8	64.2	49.7
Iron ore	32.5	50.0	89.7	92.0	89.8	62.0	77.0	70.2
Others	65.5	62.2	68.7	63.2	66.5	69.5	77.0	68.6
Manufacturing								
Sugar	70.1	51.5	46.9	85.1	86.8	70.4	57.4	69.4
Edible oil and vanaspati	45.8	42.6	64.9	58.5	48.5	46.5	69.4	62.9
Tobacco processing and manufacturing of tobacco products	65.9	60.6	65.9	48.8	64.4	72.5	69.0	47.5
Cotton textiles	85.2	86.7	85.0	91.1	83.8	79.9	85.8	83.1
Jute textiles	67.9	71.7	79.6	77.0	69.0	70.3	83.3	82.7
Silk & Synthetic fibres	60.2	61.7	66.8	60.3	61.3	55.7	59.0	56.7
Wool & woollen textiles	93.4	75.6	65.8	79.3	93.6	92.0	81.9	79.8
Other textiles	78.0	59.7	94.4	89.5	80.0	73.1	93.4	91.4
Paper and paper products	77.4	67.7	80.0	77.8	75.0	64.9	67.7	75.9

(APPENDIX IV—*Contd.*)

(**Statement No. 4**—*Contd.*)

(per cent)

Industry (1)	June 1977 (2)	September 1977 (3)	December 1977 (4)	March 1978 (5)	June 1978 (6)	September 1978 (7)	December 1978 (8)	March 1979 (9)
Leather and leather products	85.2	84.4	74.0	92.8	74.2	83.6	77.2	89.2
Rubber and rubber products	80.0	83.6	86.5	74.1	71.5	80.7	90.2	68.7
Chemicals and chemical products								
Heavy Industrial Chemicals	53.7	49.7	61.2	52.7	50.5	45.2	56.5	55.6
Fertiliser (production)	57.4	66.2	62.5	54.7	71.1	69.3	70.7	59.4
Drugs and Pharmaceuticals	55.5	67.6	62.2	61.8	58.2	59.7	61.9	62.7
Plastic and plastic products	72.4	67.6	61.2	74.3	64.5	75.4	77.4	70.6
Others	56.6	71.5	40.1	68.0	67.3	70.3	75.6	67.9
Petroleum	**4.2**	**12.0**	**40.1**	**19.8**	**10.9**	**18.7**	**18.2**	**18.6**
Cement	**45.9**	**45.6**	**41.8**	**38.6**	**35.5**	**39.5**	**60.2**	**38.6**
Basic metals and metal products								
Iron and steel	57.6	67.6	62.3	62.1	42.2	56.2	52.1	46.4
Others	64.1	57.7	62.1	52.9	50.3	50.6	51.0	40.8
Engineering (except transport equipment)								
Heavy engineering machinery (except electrical)	64.9	72.9	76.7	66.2	68.4	71.7	76.9	71.0
Electrical machinery	42.3	65.0	71.1	34.4	34.9	58.0	72.0	51.4
Light engineering (including light metal products)	61.7	69.8	76.4	71.0	72.2	72.1	79.0	73.4

(APPENDIX IV—*Contd.*)

(Statement No. 4—*Concld.*)

(per cent)

Industry (1)	June 1977 (2)	September 1977 (3)	December 1977 (4)	March 1978 (5)	June 1978 (6)	September 1978 (7)	December 1978 (8)	March 1979 (9)
Transport equipment								
Railway equipment	70.6	75.6	85.6	88.2	84.1	90.8	90.9	90.4
Other tranport equipment	87.0	72.5	61.0	62.9	68.2	62.1	79.8	74.0
Manufacturing — Others	73.5	69.8	72.0	77.6	71.6	71.5	74.7	71.6
Electricity Generation and supply	**37.8**	**35.2**	**29.2**	**29.7**	**28.7**	**31.2**	**32.9**	**29.0**
Trade								
Foodgrains	75.4	60.3	65.5	55.5	80.8	66.9	74.3	63.2
Fertilisers	78.1	29.5	9.9	34.1	73.3	38.0	24.1	30.6
Mineral oils	4.8	1.1	42.9	40.8	4.6	3.6	72.9	39.0
Raw cotton	85.3	75.0	71.6	76.3	69.7	61.6	64.2	99.2
Raw jute	16.4	7.5	9.7	3.4	7.7	35.9	68.2	68.9
Other trade	50.6	43.7	47.1	45.4	58.7	52.3	56.4	53.2
Construction companies*	..	..	..	81.7	82.4	82.6	101.6	81.2
Transport and communications*	..	..	..	19.1	26.5	33.9	34.8	44.3
Financial and Developmental institutions*	..	..	..	**50.7**	**57.5**	**56.4**	**54.2**	**60.8**
Hotels, Restaurants and Tourism*	..	..	..	..	**80.7**	**87.2**	**85.4**	**58.7**
All others	**39.3**	**54.8**	**57.6**	**63.5**	**65.4**	**62.6**	**66.0**	**69.8**
All industries (non-food credit)	**59.5**	**62.4**	**65.1**	**63.1**	63.3	**62.7**	**67.8**	**64.3**

* Separate figures for these items are not available for earlier periods.
Note : Cash credit limits include limits against overdrafts and demand loans also.

(APPENDIX IV—*Contd.*)

Statement No. 5—Cash credits, overdrafts and demand loans (non-food) classified according to sector — C A S — Form 'A' Data

(Amount in crores of rupees)

Last Friday of		Public Sector			Private Sector			Total*		
		Credit Limits	Amount Outstanding	Utilisation (per cent)	Credit Limits	Amount Outstanding	Utilisation (per cent)	Credit Limits	Amount Outstanding	Utilisation (per cent)
		1	2	3	4	5	6	7	8	9
March	1977	1613	797	49.4	2863	2023	70.7	4609	2893	62.8
June	1977	1596	691	43.3	2890	1978	68.4	4631	2757	59.5
September	1977 .. .	1530	813	53.1	2972	2012	67.7	4605	2874	62.4
December	1977	1601	874	54.6	3073	2169	70.6	4833	3148	65.1
March	1978	1882	952	50.6	3086	2201	71.3	5096	3217	63.1
June	1978	1798	910	50.6	3353	2354	70.2	5329	3376	63.4
September	1978	1947	1105	56.8	3356	2236	66.6	5477	3434	62.7
December	1978	1905	1147	60.2	3494	2532	72.5	5579	3785	67.8
March	1979	1917	1030	53.7	3643	2558	70.2	5733	3688	64.3

* Includes figures relating to co-operative sector also.

(APPENDIX IV—*Contd.*)

Statement No. 6—Distribution of outstanding credit of scheduled commercial banks according to the size of the credit limit*—B S R Data

(Amount in crores of rupees)

	As on the last Friday of						Growth (percent)	
	June 1976			June 1977				
	Credit limits	Amount outstanding	Utilisation (percent)	Credit limits	Amount outstanding	Utilisation (percent)	Credit limits	Amount outstanding
Above Rs. 10,000 and upto Rs. 1 lakh	1965 (11.7)	1382 (13.1)	70.3	2256 (12.2)	1685 (14.0)	74.7	+14.8	+21.9
Above Rs. 1 lakh and upto Rs. 5 lakhs	1902 (11.4)	1156 (10.9)	60.8	2091 (11.4)	1319 (10.9)	63.1	+ 9.9	+14.1
Above Rs. 5 lakhs and upto Rs. 10 lakhs	981 (5.9)	626 (5.9)	63.8	1091 (5.9)	695 (5.8)	63.7	+11.2	+11.0
Above Rs' 10 lakhs and upto Rs. 25 lakhs	1577 (9.4)	1003 (9.5)	63.6	1744 (9.4)	1131 (9.4)	64.8	+10.6	+12.8
Above Rs. 25 lakhs and upto Rs. 50 lakhs	1479 (8.8)	914 (8.7)	61.8	1591 (8.6)	984 (8.2)	61.8	+ 7.6	+ 7.7
Above Rs. 50 lakhs and upto Rs. 1 crore	1608 (9.6)	991 (9.4)	61.6	1774 (9.6)	1056 (8.7)	59.5	+10.3	+ 6.6
Above Rs. 1 crore and upto Rs. 5 crores	3056 (18.3)	1704 (16.1)	55.8	3146 (17.0)	1877 (15.6)	59.7	+ 2.9	+10.1
Above Rs. 5 crores and upto Rs. 10 crores	841 (9.0)	447 (4.2)	53.1	822 (4.4)	461 (3.8)	56.1	—2.3	+ 3.1
Above Rs. 10 crores	3330 (19.9)	2340 (22.2)	70.3	3986 (21.5)	2852 (23.6)	71.5	+19.7	+21.9
Composit limits and unclassified ..	—	5	—	—	4	—	—	—20.0
Total	**16739 (100.0)**	**10568 (100.0)**	63.1	**18501 (100.0)**	**12064 (100.0)**	**65.2**	+**10.5**	+**14.2**

Figures in brackets indicate percentages to the total. *This statement includes all facilities.

(**APPENDIX IV** *Concld.*)

Statement No. 7—Sizewise percentage utilisation of credit limits*— CAS—Form 'A' Data

Range of the size of credit limit (Rs.)	As on the last Friday of March 1978	June 1978	September 1978	December 1978
1 — 2 crores	68.4	66.9	64.8	68.4
2 — 5 crores	65.5	66.5	64.3	68.5
5 — 10 crores	63.5	62.8	60.5	65.1
10 — 15 crores	62.5	53.9	56.9	61.7
15 — 20 crores	58.5	57.8	60.4	64.8
20 crores and above	58.9	70.6	65.8	72.4
Overall utilisation	62.3	66.3	63.9	69.1

*This statement includes all facilities.

APPENDIX V

Quarterly Information System — Form I

Estimates for the ensuing quarter ending* ....

(000's omitted)

Name of borrower :

A. Estimates for the current accounting year indicated in the annual plan

(*a*) Production :
(*b*) Gross Sales :
(*c*) Net Sales :

B. Estimates for the ensuing quarter ending...... .....

(*a*) Production :
(*b*) Gross Sales :
(*c*) Net Sales :

C. Estimates of current assets** and current liabilities for the ensuing quarter ending.... ....

Current Assets

I. Inventory

(*i*) Raw materials

(*a*) Imported £.
(months' consumption) @

(*b*) Indigenous £
(months' consumption) @

(*ii*) Stocks-in-process
(months' cost of production) @

(*iii*) Finished goods
(months' cost of sales) @

(*iv*) Consumable stores
(months' consumption) @

II. Receivables – including bills discounted with bankers++
(months' sales) @

III. Advances to suppliers of raw materials and stores

IV. Other current assets including cash and bank balances

Total (estimated) current assets

---

*To be submitted in the week preceding the commencement of the quarter to which the statement relates.

(**APPENDIX V**—*Contd.*)

Current Liabilities

V.	Short term bank borrowings including bills discounted with bankers††	
	..........................Bank	
	..........................Bank. etc.	
VI.	Creditors for purchases of raw materials and stores††† (months' purchases) @	
VII.	Advances from customers	
VIII.	Accrued expenses	
IX.	Statutory liabilities	
X.	Other current liabilities	
	Total (estimated) current liabilities	

Notes: (*i*) Information in these forms is to be furnished for each line of activity/unit separately as also for the company as a whole and where the different activities/units are financed by different banks, the concerned activity/unit-wise data and data relating to the whole company should be furnished to each financing bank.

(*ii*) The valuation of current assets or current liabilities in these forms should be on the same basis as adopted for the statutory balance sheet, and should be applied on a consistent basis.

@(*iii*) The period is to be shown in relation to the annual projection for the relative item. If the levels of inventory/receivables are higher than the norms indicated by the bank, reasons may be given.

£(*iv*) If the canalised items form a significant part of raw materials inventory, they may be shown separately.

††(*v*) Amount of bills discounted with bankers, included in item II of Part C should be indicated separately.

†††(*vi*) Amount of bills discounted with bankers in respect of purchases, included in item V or item VI of Part C should be indicated separately.

**(*vii*) The classification of current assets or current liabilities should be made as per the usually accepted approach of bankers and not as per definitions in the Companies Act. (*e. g.* instalment of term loans payable within 12 months from the date of balance sheet should be classified as current liabilities).

Quarterly Information System — Form II

Performance during the quarter ended. . . . .*

(000's omitted)

Name of borrower :

A. Estimates for the current accounting year indicated in the Annual plan

(*a*) Production :
(*b*) Gross Sales :
(*c*) Net Sales :

B. Actual production/sales during the current accounting year (data to be furnished for the completed quarters)

	During the quarter		Cumulative position	
	Production	Sales	Production	Sales
1st quarter ended ———— ———19				
2nd quarter ended ———— ———19				
3rd quarter ended ———— ———19				
4th quarter ended ———— ———19				

C. Data relating to the latest completed quarter ended . . . . . .

	Estimate (as given in Form I at the beginning of the quarter)	**Actuals**
Production		
Gross Sales		
Net Sales		

D. Current assets and current liabilities** for the latest completed quarter ended. . . . .

	Estimate (as given in Form I at the beginning of the quarter)	**Actuals**
Current assets		
1. **Inventory**		
(*i*) Raw materials		
(*a*) Imported £ (months' consumption) @		
(*b*) Indigenous £ (months' consumption) @		
(*ii*) Stocks-in-process (months' cost of production) @		
(*iii*) Finished goods (months' cost of sales) @		
(*iv*) Consumable stores (months' consumption) @		

*To be submitted within six weeks from the close of the quarter to which the statement relates.

(APPENDIX V *Contd.*)

II. Receivables—including bills discounted with bankers ††
(months' sales) @

III. Advances to suppliers of raw materials and stores

IV. Other current assets including cash and bank balances

Total current assets

Current liabilities

	Estimate	**Actuals**
V. Short term bank borrowings including bills discounted with bankers †††		
.... Bank		
.... Bank, etc.		
VI. Creditors for purchases of raw materials and stores††† (months' purchases) @		
VII. Advances from customers		
VIII. Accrued expenses		
IX. Statutory liabilities		
X. Other current liabilities		
Total current liabilities		

Notes :

(*i*) Information in these forms is to be furnished for each line of activity/unit separately as also for the company as a whole and where the different activities/units are financed by different banks, the concerned activity/unit-wise data and data relating to the whole company should be furnished to each financing bank.

(*ii*) The valuation of current assets or current liabilities in these forms should be on the same basis as adopted for the statutory balance sheets, and should be applied on a consistent basis.

@ (*iii*) The period is to be shown in relation to the annual projection for the relative item. If the levels of inventory/receivables are higher than the norms indicated by the bank, reasons may be given.

††(*iv*) Amount of bills discounted with bankers, included in item II of Part D should be indicated separately.

†††(*v*) Amount of bills discounted with bankers in respect of purchases, included in item V or item VI of Part D should be indicated separately.

**(*vi*) The classification of current assets or current liabilities should be made as per the usually accepted approach of bankers and not as per definitions in the Companies Act. (e.g., instalment of term loans payable within 12 months from the date of balance-sheet should be classified as current liabilities).

£(*vii*) If the canalised items form a significant part of raw materials inventory, they may be shown separately.

(APPENDIX V *Contd.*)

Half-yearly operating and funds flow statements — Form III @

Name of borrower :

A. **Half-yearly operating statement** (000's omitted)

	Last year (Actuals)	Current year (Budget)	Half-year ended ....19 Estimate	Half-year ended ....19 Actuals	Current half-year ending ....19 Estimate
	1	2	3	4	5
1. Sales					
2. Less Excise duty					
3. Net Sales (Item 1 minus Item 2)					
4. **Cost of goods sold**					
(*a*) Raw materials consumption					
(*b*) Stores and spares consumption					
(*c*) Salaries and wages					
(*d*) ....*					
(*e*) Other manufacturing expenses, including depreciation					
Sub-total					
Add : Opening stocks-in-process and finished goods					
Sub-total					
Deduct : Closing stocks-in-process and finished goods					
Total cost of goods sold					
5. Gross profit (Item 3 minus Item 4)					
6. Interest and other overheads					
7. Other income/expenses Net (±)					
8. Profit before tax [Item 5 minus Items (6 ± 7)]					

@ To be submitted within a month from the close of the half-year.

(APPENDIX V—*Contd.*)

B. Half-yearly funds flow statement

(000's omitted)

	Last year Actuals +	Current year Budget	Previous half-year ended..............		Current half-year ending ....
			Estimate	Actuals	Estimate
	1	2	3	4	5
SOURCES					
Profit before tax					
Add depreciation					
Gross funds generated......					
Less taxes paid/payable...... (relating to the year)					
Less dividends paid/payable...... (relating to the year)					
A. Sub-total—net funds generated					
Increase in capital........					
Increase in Term loans/Debentures/Deferred payment liabilities........					
Increase in Public deposits..............					
Decrease in fixed assets					
Decrease in inter-corporate investments and advances					
Decrease in other non-current assets......					
B. Sub-total......................					
Increase in short term bank borrowings (including bills purchased and discounted by bankers)					
Increase in other current liabilities......					
Decrease in inventory..................					
Decrease in receivables (including bills purchased and discounted by bankers)					
Decrease in other current assets (including cash and bank balances).............					
C. Sub-total......................					
Total funds available (A+B+C)					

(APPENDIX V—*Contd.*)

	1	2	3	4	5
USES					
Increase in fixed assets..................					
Decrease in Term loans/Debentures/Deferred payment liabilities..........					
Decrease in public deposits..............					
Increase in inter-corporate investments and advances..........					
Increase in other non-current assets......					
D. Sub-total........................					
Decrease in short term bank borrowings (including bills purchased and discounted by bankers)					
Decrease in other current liabilities					
Increase in inventory					
Increase in receivables (including bills purchased and discounted by bankers)					
Increase in other current assets (including cash and bank balances).............					
E. Sub-total					
Loss (See note VII)					
Less depreciation					
Balance, i.e., Gross funds lost (—) or Gross funds generated (+)					
Add taxes paid/payable (relating to the year)					
Add dividends paid/payable (relating to the year)					
F. Sub-total—net funds lost					
Total funds used .... (D+E+F)					

(APPENDIX V—*Concld.*)

SUMMARY

	1	2	3	4	5
Long term sources....................					
Less long term uses....................					
Change in Net working capital (±)......					
Short term sources....................					
Less short term uses....................					

Notes :

(*i*) Information in these forms is to be furnished for each line of activity/unit separately as also for the company as a whole and where the different activities/units are financed by different banks, the concerned activity/unit-wise data and data relating to the whole company should be furnished to each financing bank.

(*ii*) The valuation of current assets or current liabilities and recording of income and expenses in these forms should be on the same basis as adopted for the statutory balance sheets, and should be applied on a consistent basis.

+ (*iii*) In case audited balance sheet and profit and loss account for the previous accounting year are not available, estimated/provisional figures for the previous year may be furnished in column (1) of Form III (Parts A and B) and the figures for the preceding year based on audited balance sheet should be given in an additional column before column (1).

*(*iv*) Any item of expenditure which forms a significant proportion, say 15% or more, of the total cost of production or has special significance otherwise, e.g., power in the case of aluminium industry, the information may be furnished separately, under appropriate heads.

(*v*) Under the items "Increase in term loans, debentures, deferred payment liabilities", each of the term loans and deferred liabilities, together with the names of the concerned lending/guaranteeing institutions, should be indicated separately.

(*vi*) Similarly, under the items "Decrease in term loans, debentures, deferred payment liabilities", the repayment of each of the term loans and deferred liabilities, together with the names of the lending/guaranteeing institutions, should be indicated separately.

(*vii*) Figures should be filled in here only when the total effect is net funds lost. In case of loss, if loss, taxes and dividends are more than compensated by depreciation, the amount of loss should be shown under 'Sources' against the item 'Profit before tax' with a negative figure.

APPENDIX VI

Financing a buyer of raw materials by way of bills (Drawee bills)

It has been suggested in Chapter V that banks should set apart a portion of the cash credit limit for purchase of inventory by way of bills. This system is practised by some of the banks.

If 'S' is the seller, 'B' the buyer, 'SB' seller's banker and 'BB' buyer's banker, the procedure for financing the buyer under the drawee bills system would be somewhat on the following lines :

(*a*) **Acceptance system**

'S' sells the goods (raw materials) to 'B' and draws a bill on 'B'. The bill is accepted by 'BB' i.e. buyer's banker and he sends it back to 'S'. 'S' may discount the bill with his banker 'SB' (in some cases the banker may be common to both 'S' and 'B').

(*b*) **Bill Discounting system**

Under this system, 'BB' will himself discount the bill and send the proceeds to 'S' even if he is not 'S' 's banker.

Under the Acceptance system 'B' would give authority to his banker 'BB' to accept bills drawn under the scheme. It is also possible for 'B' to have an arrangement by which 'S' may draw bills on 'B''s banker (BB)-A/c. 'B' upto a certain amount. 'BB' maintains an indirect liability ledger which would indicate the amount of bills accepted by it on behalf of 'B' so as to ensure that it is within the acceptance limit sanctioned to 'B'. In the stock statements submitted by 'B', the amount of goods purchased on credit under the acceptance limit sanctioned to 'B' will be shown separately. While calculating the drawing power in the cash credit account, the outstanding liability in respect of acceptance of bills (which will be available from the indirect liability ledger at any point of time and also separately shown in the stock statement) will be excluded and earmarked for making payment of the bills accepted by the bank on due dates. The earmarking may be done under two different methods, which are illustrated below :

	Rs.
Limit sanctioned against raw materials	200 lakhs
Amount earmarked for drawee bills	100 lakhs
Amount available for drawings against raw materials in cash credit ..	100 lakhs
Margin on stock	40%

The stocks with the borrower are as follows :

Stocks paid for	150 lakhs
Unpaid stocks other than those represented by accepted bills	40 lakhs
Unpaid stocks represented by accepted bills	50 lakhs

There will be no drawing power against unpaid stocks of Rs. 40 lakhs not represented by accepted bills. The amount of Rs. 50 lakhs represented by accepted bills can be verified by the bank from the indirect liability ledger for such bills.

Under Method I, the drawing power (DP) will be calculated as follows :

Stocks paid for	Rs. 150 lakhs
Stocks represented by accepted bills..	Rs. 50 lakhs
Total	**Rs. 200 lakhs**

(APPENDIX VI—*Concld.*)

D.P.@ 60%	Rs. 120 lakhs
Amount earmarked for accepted bills	Rs. 50 lakhs
D. P. available against stocks	Rs. 70 lakhs

Under Method II, the DP will be calculated as follows :

Stocks paid for	Rs. 150 lakhs
D. P. against stocks paid for	Rs. 90 lakhs

Under the II method, the margin against stocks represented by accepted bills will be provided only when the bills are actually met by the bank, whereas under the 1st Method, such margin will be provided at the time of acceptance of the bill.

In the above illustrations, under Method I, other things remaining the same, when the accepted bills become due for payment, they can be debited to the account without causing any irregularity in the account. But under the II Method if the drawings are to the full extent of the D.P. against stocks when the bills are debited to the account, other things remaining the same, the account will become irregular to the extent of the margin on the stocks represented by the bills debited to the account. For example, in the illustration given under Method II, when the drawings at Rs. 90 lakhs are equal to DP and if accepted bills amounting to Rs. 30 lakhs are debited to the account, the balance will be Rs. 120 lakhs as against the revised DP of Rs. 108 lakhs resulting in excess drawing over DP of Rs. 12 lakhs (equivalent to 40% of Rs. 30 lakhs). The party will then have to be called upon to regularise the account.

It would be obviously in the interest of the banks to follow method No. I.

Bill Discounting system

Under this system, 'BB' will discount the bill and pay off 'S' under an arrangement among 'S', 'B' and 'BB'. The bill will remain in 'BB''s books as 'bill discounted'. In the case of discounting of drawee bills by banks, Reserve Bank has advised banks that the rate of interest should be the same as that applicable for advances against pledge/hypothecation of the stocks subject to the minimum lending rate. The banks should in respect of such bills earmark suitably the D/P available against stocks after providing the prescribed margin.

But for certain operational inconvenience and also some increase in the work load of the borrower's bank, both the systems (acceptance as well as discounting of bills drawn on the buyer) have several advantages to the various parties as under :

(*i*) **Seller** : He is assured of payment on a definite date. This would particularly benefit small-scale industries who supply goods on credit and do not get payment of their bills from medium/large industries in the public and private sectors in time. Further, since the bill is accepted by a banker, he gets a finer rate of discount.

(*ii*) **Buyer** : Since the bill drawn on him is accepted by a banker he could get the advantage of competitive rates for his purchases by way of a discount. He will also have no difficulty in satisfying the bank of the amount of unpaid goods with him to the extent such goods are covered by bills. He also gets the benefit of acquiring additional stocks comparatively easily on the strength of his banker's acceptance of such bills.

(*iii*) **Buyer's bank** : The bank runs no risk in accepting such bills as the goods covered by acceptance limits are charged to it and the amount of bills is secured by the stocks covered by such bills. To the extent stocks are purchased under bills, the bank has ready information regarding the purchases made on credit by the borrower and he need not depend solely on the borrower's declaration to that effect in respect of such goods.

(*iv*) **Seller's Bank** : As the bills are accepted by a bank, his investment is safe and he can re-discount such bills as and when necessary, with other institutions